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EXPIRING CIGARETTE EXCISE TAX PROVISIONS

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BEFORE THE

SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

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EXPIRING CIGARETTE EXCISE TAX PROVISIONS

TUESDAY, SEPTEMBER 10, 1985

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT,
Washington, DC.

The committee met, pursuant to notice, at 9:52 a.m., in room SD-215, Dirksen Senate Office Building, Hon. John H. Chafee (chairman) presiding.

Present: Senators Chafee, Durenberger, Symms, and Bradley.

[The press release announcing the hearing, the statements of Senators Chafee, Durenberger, Bentsen, and Boren, and a report by the Joint Committee on Taxation follow:]

[Press Release No. 85-065, Aug. 9, 1985]

FINANCE COMMITTEE TO HOLD HEARING ON EXPIRING CIGARETTE EXCISE TAX PROVISIONS

The Senate Finance Committee's Subcommittee on Taxation and Debt Management will hold a hearing on the expiring 16-cent cigarette excise tax provisions, on Tuesday, September 10, 1985, Committee Chairman Bob Packwood (R-Oregon) announced today.

Cigarette excise taxes were extended from 8 cents per pack to 16 cents per pack as a part of the Tax Equity and Fiscal Responsibility Act [TEFRA] in 1982. This extension is scheduled to expire on September 30, 1985. If Congress takes no action, the excise tax will revert back to 8 cents per pack.

Senator Packwood indicated that the chairman of the Subcommittee on Taxation and Debt Management, John Chafee (R-Rhode Island), will preside at the hearing.

The hearing will begin at 10 a.m. in room SD-215 of the Dirksen Senate Office Building.

STATEMENT BY SENATOR JOHN H. CHAFEE

Medical evidence of the incidence of tobacco-related diseases among users of cigarettes demonstrates the correlation between smoking and increased health care costs. An increased Federal excise tax on cigarettes is a tax imposed on tobacco users for the resulting excess health care costs they impose on our health care system.

The current excise tax of 16 cents will fall to 8 cents per package as of October 1, 1985 unless Congress acts. I believe it would be a mistake to allow the tax to fall. In fact, I have introduced legislation in the Senate which would increase the tax to 32 cents per package.

My legislation, S. 874, would continue the tax at 16 cents until January 1, 1986 and then increased it to 32 cents. The increase (16 cents) would be earmarked to the Hospital Insurance Trust Fund—Part A of the Medicare Program.

There are other proposals in the House and Senate which would either increase or continue the excise tax on cigarettes. These proposals take different approaches to the issue; however, I believe they show a sentiment on the part of many in Congress, at the very least, to continue the tax at its current level.

According to the Coalition on Smoking Or Health, in 1981 cigarette smoking accounted for $13 billion in medical care costs and $25 billion in lost economic productivity. Cigarette smoking cost taxpayers $3.8 billion through the Medicare and Medicaid programs.

Smokers clearly impose a burden on society. Their health care needs are subsidized by those who do not smoke. It is reasonable, therefore, to ask smokers to contribute additional funds toward the health care programs that are of assistance to them.

The recognition of the health care demands smokers make on health care programs is especially important when we look at the Medicare program. The Hospital Insurance Trust Fund is still in trouble. Although the actuaries disagree as to the exact projected date of the bankruptcy of the program, few will disagree with the proposition that measures need to be taken to ensure its long term viability.

By the year 2000, only 15 years away, the number of people over age 65 in the United States will increase by 18 percent. Those over age 85 will double. These figures are nothing compared to what will happen in the next century; moreover, they are probably conservative. These statistics leave us with clear and unequivocal evidence of the need for prompt, effective and above all careful action. We know what dragging our feet now will mean for the future of health care for the elderly—a bankrupt system.

While an increased excise tax on tobacco, earmarked to the Trust Fund, may not ensure that the fund will remain solvent, it will certaintly help to increase the revenues flowing into the trust fund.

An increased excise tax on this product will also help discourage smoking. In the Tax Equity and Fiscal Responsibility Act [TEFRA], Congress doubled the excise tax on cigarettes from $.08 to $.16 for a three year period ending October 1, 1985. In "Cigarette Taxation: Doing Good by Doing Well," author Kenneth Warner stated that the doubling of the excise tax caused one and a quarter million adult Americans to stop smoking and one-half million teenagers to stop or not start smoking. Among price-responsive young people, teenage smoking decreased by 14 percent. Adult smoking decreased by 4 percent.

By helping to discourage smoking, an increased excise tax will help improve the overall health of the country. Cigarette smoking is the number one preventable cause of death and disability in this country. 340,000 die of smoking related disease annually. Nine million people suffer from chronic bronchitis and emphysema due to smoking.

Yesterday I received a copy of a report released by Harvard University's Institute for the Study of Smoking Behavior and Policy which contains the proceedings of a conference on cigarette excise taxes. This report clearly shows that allowing the tax to fall could induce hundreds of thousands of today's teenagers to take up smoking in the coming years. I recommend this report to all of you as we examine the issue of the excise tax.

There are those who say that smoking is a decision each of us should make and that Congress should not be attempting to influence these decisions through a excise tax. However, there are some personal decisions which have a great impact on all of society—smoking falls into this category. It creates an increased demand on our health care system, much of which is subsidized by the Federal Government. All of us, whether we smoke or not, pay for the health care needs of smokers—either through insurance premiums or our taxes.

In these times of fiscal austerity, we must closely examine the health care costs imposed on taxpayers by tobacco users. I believe it is reasonable to ask those who smoke to help ensure the financial viability of the Medicare program which is depended upon by so many elderly individuals.

Some of the witnesses today will also be discussing the issue of an excise tax on smokeless tobacco. There has been no excise tax on this product since 1965 when the tax was 10 cents per pound. I am contemplating legislation to institute an excise tax on smokeless tobacco.

Frankly, I find the use of this product among teenagers appalling. It seems clear to me that one of the reasons they use the product is to substitute for cigarettes. Most teenagers who don't smoke but use chewing tobacco sincerely believe that it is not a health risk. In my opinion this is a dangerous and unfounded belief. Anyone who has followed the recent media reports on the use of this product should be concerned about the health risk.

I welcome all of the witnesses and look forward to their testimony.

STATEMENT OF SENATOR DAVE DURENBERGER

THE DISEASE PREVENTION AND HEALTH PROMOTION ACT OF 1985

Current law: The Federal excise tax on cigarettes was set at 16 cents in 1982. This law sunsets on October 1, 1985 when the Federal cigarette tax would revert back to 8 cents per pack.

Durenberger proposal: The Durenberger bill, The Disease Prevention and Health Promotion Act of 1985, will be introduced on September 10, 1985.

The bill will:

1. Retain the 16-cent cigarette tax.
2. Set up a disease prevention and health promotion trust fund to which 8 cents of the 16-cent tax would go.
3. Funds from the Trust Fund would then be distributed to the States to be spent on prevention programs.
4. States would be given the option of using the prevention funds to supplement the current prevention Federal block grants (the Maternal Child Health, Preventive Health, and/or Alcohol Drug Abuse and Mental Health Block Grants) or spending the funds on new preventive health initiatives.
5. Funds will be distributed according to a formula based on each State's population and percent of residents below the poverty level.

STATEMENT OF SENATOR LLOYD BENTSEN

Mr. Chairman, this year, approximately 350,000 Americans will die of smoking-related disease. An additional 9 million suffer from chronic bronchitis and emphysema. In addition to the tremendous personal and societal loss this represents, the economic cost is staggering. In 1981 it was estimated that these costs totaled $13 billion in additional medical care, $25 billion in lost worker productivity, and placed a particularly acute burden of $3.8 billion on the Medicare and Medicaid programs.

At the same time, our Nation is facing the prospect of enormous budget deficits for the forseeable future, even under the most optimistic economic assumptions. According to the most recent estimates by the Congressional Budget Office, deficits will remain well above $100 billion for the next five years. According to the Treasury Department, the current excise tax on cigarettes is generating $5 billion in revenue annually. Proposals to increase the tax from 16 to 32 cents per pack would generate an additional $2 to $3 billion per year.

At a time when our country is saddled with a national debt fast approaching $2 trillion and our health care costs continue to soar well ahead of the pace of inflation, it does not make sense to permit the excise tax on tobacco to drop to 8 cents as currently scheduled.

The 1982 tax bill raised the cigarette excise tax for the first time in 31 years and represented only the third increase in post-war times. A major justification for this increase was that the effective tax had actually declined by 70 percent since 1951. Nothing has changed since then that would diminish the reasons for an excise tax of at least 16 cents; the federal tax as a percentage of cigarette prices now stands at only 16.6 percent.

Consequently, I urge my colleagues not only to support its retention but to also give serious consideration during these deliberations to adjusting the tobacco excise tax upward to reflect its continued decline in constant dollars.

I am also aware that several of my colleagues have suggested the idea of raising the cigarette tax and earmarking some of the tax to medicare. I think this is an idea that we should seriously consider. There is an undeniable link between cigarette smoking and medicare costs. It seems fair to me to require smokers to pay a higher share of medicare costs through an increase in the cigarette excise tax.

STATEMENT OF SENATOR DAVID L. BOREN

Mr. Chairman, I believe that the Congress, in light of the now projected $210 billion deficit for this year, must take any and all steps necessary to address this crisis!

This hearing is to gather information from both sides of the issue of extending the additional 8 cents per package of cigarettes destined to expire this year. So many arguments come to my mind for the continuation of this tax and I wish to share a few with the committee.

The Federal excise tax on cigarettes in 1919 was 6 cents per pack and raised in 1951 to 8 cents. This tax in 1951 represented 37 percent of the price of a pack of cigarettes. The present 16 cents is less than 20 percent of the average price today. To cut it in half back to 8 cents would be a 75-percent reduction over 1951 and 8 cents would be 10 percent of the price indefensible in light of our budgetary problems.

In the Tax Equity and Fiscal Responsibility Act of 1982, the Federal excise tax of an additional 8 cents per pack was imposed to address what was considered a deficit crisis at that time. The decision was made to discontinue the tax in 1985 because the deficit projected was $60 billion which has turned out to be ludicrous.

Federal outlays for smoking related illness and death are considerable. Six percent of Medicare is paid for smoking victims and 12 percent of Social Security disability recipients are smoking victims. The loss of earnings is estimated at $25 billion per year and $14 billion is spent for medical care. There are 300,000 smoking related deaths per year and 30 percent of the 400,000 cancer deaths are caused by smoking.

In light of these accurate and frightening statistics, I firmly support the continuation of the present Federal excise tax on cigarettes. The fact that cigarettes, exempted from State and local taxes, are sold more cheaply in commissaries and exchanges by the Department of Defense has disturbed me for a long time. I have asked the appropriations defense subcommittee, in the fiscal year 1986 appropriations bill, to require DOD to charge prevailing prices for cigarettes as is already done for the purchase of liquor.

In my view, the Finance Committee should continue the Federal excise tax on cigarettes and raise further revenue through such avenues as an oil import fee. The cigarette tax will raise a projected $1.5 billion and the oil import fee could raise $8.6 billion for a total of over $10 billion in 1986 alone.

I appreciate the opportunity to make this statement during this hearing and urge quick action to bring this issue to the floor of the Senate.

EXCISE TAX RATES ON CIGARETTES

(Prepared For the Hearing on September 10, 1985, Before the Senate Finance Subcommittee on Taxation and Debt Management)

Present Law and Background

An excise tax is imposed on cigarettes manufactured in or imported into the United States (Code sec. 5701(b)). The tax is determined when the cigarettes are removed from the factory or released from customs custody. The present rate of tax on small cigarettes is $8 per thousand (i.e., 16 cents per pack of 20 cigarettes). The tax rate on large cigarettes generally is $16.80 per thousand; proportionately higher rates apply to large cigarettes that exceed 6.5 inches in length. Small cigarettes are cigarettes weighing no more than 3 pounds per thousand; large cigarettes are cigarettes weighing more than 3 pounds per thousand. Nearly all taxable cigarettes are small cigarettes.

The current cigarette tax rates were enacted in the Tax Equity and Fiscal Responsibility Act of 1982 (sec. 283 of P.L. 97-248), for the period January 1, 1983, through September 30, 1985. On October 1, 1985, the present cigarette excise tax rates are scheduled to decrease to $4 per thousand (i.e., 8 cents per pack of 20 cigarettes) for small cigarettes and to $8.40 per thousand for large cigarettes, that is, to the rates in effect before 1983.

Revenues from the excise tax on cigarettes are deposited in the general fund of the Treasury.

Administration Proposal

The Administration's fiscal year 1986 budget proposal assumes that the scheduled reduction in the cigarette tax rates under present law will take place.

Other Proposals

The following Senate bills regarding cigarette tax rates have been introduced thus far during the 99th Congress.

S. 820 (Senator Heinz)

This bill would permanently extend the 16-cents per pack cigarette tax rate.[1] One-half of revenues from the tax imposed on cigarettes after September 30, 1985 (i.e., 8 cents per pack) would be allocated to the Federal Hospital Insurance (Medicare) Trust Fund.

S. 874 (Senators Chafee and others)

S. 874 would impose a 32-cent per pack tax rate on cigarettes after December 31, 1985. One-half of these tax revenues (i.e., 16 cents per pack) would be allocated to the Medicare Trust Fund. The bill also contains floor stocks provisions, with an exception for retailers.

Senator Durenberger

Senator Durenberger's proposal (to be introduced) would permanently extend the 16-cents per pack rate. One-half of revenues from the tax imposed on cigarettes after September 30, 1985 (i.e., 8 cents per pack) would be allocated to a new Federal Disease Prevention and Health Promotion Trust Fund for making grants to State and local governments for approved disease prevention and health programs.

Other Congressional Action

H.R. 3128, as reported by the House Committee on Ways and Means on July 31, 1985 (H. Rep. No. 99-241, Part 1), would extend the current cigarette tax rates (i.e., 16-cents per pack on small cigarettes on a permanent basis.

One-sixteenth of cigarette excise tax revenues (i.e., 1 cent per pack of 20 cigarettes) would be appropriated to a newly established Tobacco Equalization Trust Fund, for the period October 1, 1985, through September 30, 1990, for use in the Federal tobacco price support program. The remaining 15 cents per pack would continue to be deposited in the general fund.

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[1] Tax rates mentioned are per pack of 20 small cigarettes. The rates on large cigarettes would be adjusted proportionately in each case.

Senator **Chafee**. The next hearing will be on the cigarette excise tax. We have a panel consisting of three distinguished colleagues. And I don't see them all here, but Senator Helms is here, and I know he has another engagement. So, Senator, why don't you proceed?

Senator **Symms**. Mr. Chairman, while Senator Helms is getting up there, I would like to make a comment on this next hearing, if I might. I just want to say that I have to chair a hearing at 10 in this building. I will be away from here for a little while, but if I can't get back, I want to make one point here. In my State, about three-fourths approximately of our State budget is for education. And with our economy in a flat situation in the State, we are having a very difficult time funding our public school system, and we have a lot of very fine teachers that work for very much less pay, than people do here in the Nation's Capital and inside this beltway. I would like to see that extra 8 cents a package on cigarettes preserved for the States, so that States like Idaho and others, if they have to look for new means of State revenues to educate the young children in the State, could at least look to that cigarette tax as a means of funding the State Government. And I think it would be a terrible mistake if the Congress decides that they can have a very inexpensive way to add to tax revenues to extend this tobacco tax. And I hope that we do not do so.

Senator **Durenberger**. Mr. Chairman, I have a statement that I would like to withhold until after our colleagues present their testimony.

Senator **Chafee**. What I thought I might do, if it is agreeable with the members of the committee, is to let Senator Helms proceed since he has to chair an Agricultural Committee meeting at 10. And then, we would have an opportunity to submit our statements. So, Senator, why don't you proceed?

STATEMENT OF HON. JESSE HELMS, U.S. SENATOR FROM THE STATE OF NORTH CAROLINA

Senator **Helms**. Mr. Chairman, I thank you very much. You are talking about the joys of this committee. You haven't had any fun until you have been chairman of the Senate Agriculture Committee in the year 1985. I often contemplate that I never knew before now how to define pergatory. Now I know. It is being chairman of that committee this year. Mr. Chairman and gentlemen of the committee, I ask unanimous consent that a statement by my distinguished colleague from North Carolina, Senator East, be included in the record.

Senator **Chafee**. Yes, fine.

Senator **Helms**. And Mr. Chairman, in the interest of time, I am going to summarize my statement, and I would hope that the entire statement would be made a part of the record.

Senator **Chafee**. It will be.

Senator **Helms**. I thank the Chair. I am grateful for the courtesy in permitting me to appear to discuss the commitment made by Congress in 1982 to sunset the cigarette tax increase adopted that year. The sunset of this revenue measure is not merely a question of tax policy. Congress has in my judgment a commitment to honor—a commitment made in 1982 by the Senate, agreed to by the House of Representatives and signed into the law by the President—and that commitment was sustained last year by the Senate Finance Committee when it rejected a proposal to extend the tax. And the distinguished chairman of this subcommittee was among those in the Senate who, from my perspective, voted right on every one of those occasions, and I commend him for his decision and thank him for his support. But now, he is exercising the right to change his mind, and I hope I may be able to make a few points now and subsequently to persuade him to change his mind once more and uphold the 1982 commitment made by Congress. First of all, Mr. Chairman and gentlemen of the committee, I would appeal to you on the basis of the continuing damage to the economy of North Carolina and other States. The tax has taken a toll in terms of sales and jobs and payrolls. And as a matter of fact, a regressive excise tax like this tax raises the price disproportionately for those in the lower income groups. The result: a drop in sales, lower earnings for hundreds of thousands of farmers and others who make their livings in the production of tobacco and tobacco products; and it also results in lost jobs and job opportunities. Now, I can testify beyond any apparent venture whatsoever, Mr. Chairman, that tobacco farmers and farmers all over this country are already plagued with many serious problems: the strong dollar, declining exports, increasing imports, the cost of the program, and so forth. Now, while it is outside the jurisdiction of this committee, please indulge me to mention that I have introduced legislation in the Senate, S. 1418, designed to address the fundamental problems of the tobacco program. And my bill will enable us to dispose of the enormous inventory of tobacco in Government storage and make sure that it does not build up again in the future. Tobacco growers will benefit if manufacturers agree to buy the existing inventory and split 50-50 with farmers any future no-net cost assessments. In return, manufacturers will be able to buy tobacco in the future under a more market oriented price support. It will also have input in determining the marketing quotas. Now, I anticipate this legislation will be considered by the Senate in the near future, and I mention it to underscore the fact that the Senate Agriculture Committee is trying to resolve the problems plaguing the tobacco farmers. Now, back to the excise tax, which should be and I hope will be sunsetted at the end of this month. This is a national problem in scope. Those who depend on the tobacco industry for all or part of their incomes live everywhere. For example, even though not a stalk of tobacco is grown in Rhode Island, wholesaling and retailing of tobacco products have always been a dynamic economic force in the ocean State. One economic impact study found that 2 percent—2 percent—of all private sector jobs, or the equivalent of 1 in every 50 jobs, of course, are generated directly or indirectly by tobacco, and the wages of this employment exceeded $110 million a year. I hope that this tax will not be regarded as a political football. I know it won't. And I hope Congress will understand most of all that keeping a commitment is a matter of honor and a matter of fair play. I thank the chair, and I thank the members of the committee.

Senator CHAFEE. Thank you, Senator.

[The prepared written statements of Senators Helms and East follow:]

STATEMENT OF SENATOR JESSE HELMS

Mr. Chairman, distinguished members of this subcommittee:

I am grateful for your courtesy in permitting me to appear to discuss the commitment, made by Congress in 1982, to "sunset" the cigarette tax increase it adopted that year.

The sunset of this revenue measure is not merely a question of tax policy. Congress has a commitment to honor—a commitment made in 1982 by the Senate, agreed to by the House of Representatives, and signed into law by the President.

That commitment was sustained last year by the Senate Finance committee when it rejected a proposal to extend the tax increase.

The distinguished Chairman was among those in the Senate who, from my perspective, voted right on every one of those occasions, and I commend him for his decision and thank him for his support.

Now, he has exercised his right to change his mind. I hope I may be able to make a few points to persuade him to change his mind once more, and uphold the 1982 commitment made by Congress.

First of all, Mr. Chairman, I would appeal to you on the basis of the continuing damage to the economy of North Carolina. The tax has taken a toll in terms of sales, jobs, and payrolls. A regressive excise tax, like this tax, raises the price disproportionately for those in the lower income groups. The result: a drop in sales, lower earnings for hundreds of thousands of farmers and others who make their living in the production of tobacco and tobacco products. It also results in lost jobs and job opportunities.

Tobacco farmers are already plagued with many serious problems—the strong dollar, declining exports, increasing imports, a costly program, etc.

While it is outside the jurisdiction of this Committee, let me add that I have introduced legislation in the Senate—S. 1418—designed to address the fundamental problems of the tobacco program. My bill will enable us to dispose of the enormous inventory of tobacco in government storage and make sure it does not build up again in the future.

Tobacco growers will benefit if manufacturers agree to buy the existing inventory, and split 50-50 with farmers any future no-net-cost assessments. In return, manufacturers will be able to buy tobacco in the future under a more market-oriented price support. They will also have input in determining the marketing quotas.

I anticipate this legislation will be considered by the Senate in the near future, and I mention it to underscore the fact that the Senate Agriculture Committee is trying to resolve the problems plaguing the tobacco farmers.

Since the Federal cigarette tax was doubled in 1982, cigarette sales have decreased by more than 2 billion packs annually. With an average price per pack around a dollar, the loss approaches two billion dollars.

That jolt at the cash register has a whiplash-effect that is felt by farmers, workers, manufacturers, distributors, and a host of other businesses and employees in industries that depend on the production of tabacco and tobacco products.

This is a national problem in scope. Those who depend on the tobacco industry for all or part of their incomes live everywhere. For example, even though not a stalk of tobacco is grown in Rhode Island, wholesaling and retailing of tobacco products have always been a dynamic economic factor in the Ocean State. One economic impact study found that two percent of all private sector jobs—or the equivalent of one in every 50 jobs—are generated directly or indirectly by tobacco, and the wages of this employment exceeded $110 million a year.

So, when economic distress occurs in tobacco, it is borne by many industries—paper, chemicals and plastics, packaging and containers, farm equipment, fertilizer, transportation, printing, publishing, advertising and media, and ultimately by the consumer. And this is in every State.

The question arises: If the Senate reneges on the sunset provisions to which it committed in 1982, will it really solve the problems which this distinguished Committee of the Senate is trying to solve—tax reform, and the Federal deficit?

Would breaking the sunset commitment contribute to tax reform? The answer is no. Indeed, keeping the tax at 16 cents, instead of living up to the Senate's commitment, goes against the principles of neutrality, fairness and growth.

Would it help reduce the Federal deficit? Not much, if any. The overwhelming sentiment among the electorate is for reducing the Federal deficit by reducing Federal spending, not by raising taxes. The deficit is so huge and the tobacco tax is relatively small. It is clearly punitive to single out this product and its consumers to bear a tax increase.

I hope the tax is not used in this way. And I hope Congress will understand that keeping a commitment is a matter of honor and fair play.

Thank you very much.

STATEMENT OF SENATOR JOHN P. EAST

Mr. **EAST**. Mr. Chairman, thank you for this opportunity to discuss the most important subject in North Carolina—tobacco. In 1982 we in Congress committed ourselves to increase the cigarette excise tax from 8 cents to 16 cents per pack of 20 cigarettes. As part of this agreement, at the end of this month the excise tax is due to revert back to the original level of 8 cents. There are several reasons why we should honor this commitment and let the federal cigarette excise tax to revert back to 8 cents.

Since the increase, consumers of tobacco products have born an inordinate share of the taxes that are imposed at all levels of government. Smokers paid federal, state, and local governments more than $9 billion in tax revenue last year. That amount, levied on 28.5 billion cigarette packs, represented an increase of $1.5 billion over the previous year and more than three times the amount our small, struggling tobacco farmers made for their 1984 crop. Last year the federal excise tax alone raised $4.7 billion.

This increased excise tax hurt most the people who are least able to pay. Recently, Professor V. Glenn Chappell released a study on the impact of tobacco taxes. Professor Chappell is an old colleague of mine from the faculty of East Carolina University, where I taught for 16 years. I think the proponents of this regressive tax would find this study rather interesting. Let me add for the record a short quotation from this study.

"While tobacco taxes may be attractive sources of additional revenues, their imposition is not without some surprising and serious negative effects. In terms of economic efficiency, tobacco taxes restrict output, raise prices, distort consumer decisions, and reduces overall economic welfare. Furthermore, tobacco taxes are inequitable. They are inequitable both because they discriminate against consumers who prefer the taxed tobacco products and because the tobacco products that are taxed are those comprising a larger portion of poor and minority consumers' budgets."

So you see, Mr. Chairman, the temporary increase in the cigarette excise tax has damaged not only the economy of North Carolina, but the economic welfare of 55 million Americans who choose to smoke, the nearly 700,000 families directly engaged in producing tobacco, the 276,000 family farms that depend on tobacco for their livelihoods, and the 50,000 workers who earn their living manufacturing tobacco.

It is imperative that on October 1, 1985 the federal cigarette excise tax should be lowered, as scheduled, to 8 cents per pack. I urge this Subcommittee on Taxation and Debt Management to honor this commitment.

Thank you.

Senator **CHAFEE**. In your statement, you noted several problems with the tobacco industry: The strong dollar, declining exports, costly programs, and you also include increasing imports. Is that a problem for cigarettes?

Senator **HELMS**. You betcha. You betcha, Mr. Chairman. And we are going to reverse that if, as and when, my bill is enacted into law. Roughly 50 percent of every cigarette manufactured in this country at this time consists of imported tobacco. And I won't go into that in any great detail, but this has caused a lot of heartburn in many areas including the people who are opposed to smoking because of the chemical residue on imported tobacco and that sort of thing, but it is an enormous problem.

Senator **CHAFEE**. Where does it come from, Senator? What are the principal nations?

Senator **HELMS**. Brazil is giving us a fit right now, and of course, we have to have the Turkish tobacco for blending purposes and that sort of thing.

Senator CHAFEE. All right. Thank you. Senator Durenberger.

Senator DURENBERGER. Thank you, Mr. Chairman. Senator Helms, let me ask you just one question. How would you respond to the kind of testimony we are going to hear this morning that a large national tax on tobacco is essential to decrease the consumption of tobacco by the American public? I think that is the general argument that will be made by a number of people.

Senator HELMS. Senator, I, of course, would not presume to suggest how you would respond. You are an eloquent, articulate Senator, but is that the purpose of tax policy? I think that needs to be discussed, and it is a regressive tax, whether you like smoking or not—and a lot of people don't and a lot of people do—but it falls hardest on the low-income people.

Senator DURENBERGER. Thank you.

Senator HELMS. Thank you very much. Now, I will go to my committee meeting.

Senator CHAFEE. Yes. Senator Helms, obviously the questions we are going to be wrestling with here are statistics like those presented by the Coalition on Smoking Or Health. In 1981, cigarette smoking accounted for $13 billion—that is in 1 year—in medical care costs and $25 billion in lost economic productivity. That is plus the cost smokers impose on Medicare and Medicaid. These are the types of questions we are going to be dealing with.

Senator HELMS. Undoubtedly. Mr. Chairman, I have never tried to debate the smoking question. Some of these statistics are debatable, but I don't have a computer to say they are right or wrong, but I imagine that you may have——

Senator CHAFEE. We are going to have testimony from the tobacco growers associations and the tobacco industry.

Senator HELMS. That I understand.

Senator CHAFEE. Fine. Thank you very much for coming, Senator. I appreciate your being here.

Senator HELMS. Thank you, and I appreciate the opportunity.

Senator CHAFEE. Senator Ford, we are ready for your testimony if you are prepared to go ahead.

STATEMENT OF HON. WENDELL H. FORD, U.S. SENATOR FROM THE STATE OF KENTUCKY

Senator FORD. Mr. Chairman, I don't know if we are ready or not, but we will proceed.

Senator CHAFEE. All right. We welcome you here and look forward to your comments. Why don't you proceed?

Senator FORD. Fine, thank you very much, Mr. Chairman and Senator Durenberger. In the interest of time, Mr. Chairman, I will make a few brief remarks this morning, and I will submit my full statement for the record.

Senator CHAFEE. Fine.

Senator FORD. I appreciate the opportunity to testify before the Subcommittee on Taxation and Debt Management in opposition to proposals to extend the current 16 cents excise tax on cigarettes. Quite simply, the extension of this tax would mean the end of many family farms in Kentucky, and I would like to underscore, Mr. Chairman, the end of many family farms in Kentucky. Kentucky is the largest producer of burley tobacco. Most of the 101,000 farms in the State are family operations which have been passed down from generation to generation. It is not unusual to have a single farm supporting more than one family. I have been asked how much can such a small farming unit support its operations. And the answer is simple: Tobacco. Kentucky is tobacco, and any move to extend or increase the excise tax will have a substantial negative impact on the economy of Kentucky. According to the U.S. Department of Agriculture, since 1983 when the additional 8 cent tax was imposed, cigarette output fell 4 percent and has never recovered. For every 1 percent of the market, there are roughly 288 million in retail sales. Therefore, this 4 percent drop caused a significant total reduction in sales of over $1 billion annually. There is a grave misconception about just what the effect of this drop in sales means. It does not mean that cigarette manufacturers lost money. Nothing could be further from the truth. The management of these companies did what any management worth its salt would do. It simply cut costs to maintain profit levels. And one way to reduce costs is to buy more of the cheaper imported tobacco and less Kentucky burley. In 1981 and 1982, the companies used 463 and 444 million pounds of domestic burley respectively. By 1983, only 388 million pounds of domestic burley was used, almost a 17 percent drop. This trend could spell disaster with small tobacco farmers who operate the 101,000 farm families in my home State. Failing to allow the excise tax to sunset will only continue to force the cigarette manufacturers to find ways of reducing their use of domestic tobacco in order to maintain profits, which translates into troubles for the Kentucky farmer and the State economy as a whole. Every time we reduce tobacco production by 1 percent in my State, 1,183 jobs are lost, or the total State product declines by some $24 million. The 8 cent additional excise tax added in the 1982 Tax Act was to have been only a temporary revenue raising measure, and with good reason. Not only is the cigarette excise tax a highly regressive tax which conflicts with our very notion of a fair and equal system of taxation, it actually has the unintended effect of increasing imports. As the manufacturers look for a way to reduce costs, they turn to cheaper tobacco produced overseas by countries whose depressed standards of living support very cheap labor. Tobacco is a highly labor intensive crop, and those areas of the world where labor costs are very low can produce a less expensive crop. It cannot compete with the quality, however, of our domestic crop, but it sure can save the manufacturers money. And I don't have to tell this committee what the effect of increasing imports will have on our balance of trade. This is an inherently bad tax. It is highly regressive and punitive at best. The health groups will tell you that their goal is to produce a smoke-free society by the year 2000. That may be a legitimate goal for a private interest group, but it is not one that the U.S. Congress should be helping to achieve through taxation. To extend the tax past the sunset date would have a devastating effect on farmers in my State and would fly in the face of responsible tax policy, and the work Congress, and particularly this committee, is doing to achieve true tax reform. If we are serious about providing tax relief to those income groups and if we are sincere in our desire to design a tax system that falls evenly on all, then an extension of this tax is the wrong way to go. As the chairman knows full well, there are several proposals for earmarking any extension of the tax for specific purposes. I am opposed to any such earmarking. It is a bad precedent and an unfair one. The health groups claim that cigarette smoking has cost the taxpayers $3.8 billion through Medicare and Medicaid programs. Now, Mr. Chairman, the total actual cost to the Federal Government of the Medicaid and Medicare programs for fiscal year 1984 was approximately $83 billion. If tobacco users account for only $3.8 billion of that, then clearly, Mr. Chairman, there must be a group responsible for a much larger share of these costs. To limit the review to only the $3.8 billion, allegedly associated with tobacco users, points out the true purpose of such proposals. The purpose of such a tax is quite simply to reduce cigarette consumption and, to my knowledge, I am not aware of any other area where Congress uses tax policy to force its citizens into a particular social behavior. Mr. Chairman, the doubling of the cigarette excise tax was meant as a temporary revenue raiser. Its effect on the small family farmers in my State has been hard, but an end was always in sight. To extend this tax now would force many of my constituents to sell the family farm, which has been their way of life for generations. To extend or increase such a tax would be disastrous, coming at a time when the tobacco farmer is being called on to accept changes in tobacco programs and bear a larger portion of its cost. To earmark such a tax would be punitive only and would miss by a wide margin the stated goal of such action. As this committee continues to debate tax reform and deficit reduction, I hope it will keep in mind that the bottom line of any such action is that the Kentucky burley farmer will suffer. And Mr. Chairman, I would like to submit for the written record the testimony of the Honorable Martha Lane Collins, Governor of the Commonwealth of Kentucky, and Mr. Ed Sutton, president of Kentucky National Farmers Organization.

Senator CHAFEE. Yes, that will be included in the record.

Senator FORD. I thank the chairman, and we would be willing to attempt to answer any questions he might want to ask.

Senator CHAFEE. Thank you, Senator, for that very interesting testimony. The information on the average income of farmers and farm groups, and the effect of tobacco on their income, is important for us to have as we examine this issue.

[The prepared written statements of Senator Ford, Governor Collins, and Mr. Sutton follow:]

STATEMENT OF SENATOR WENDELL H. FORD

Mr. Chairman: I appreciate the opportunity to testify before the Subcommittee on Taxation and Debt Management in opposition to proposals to extend the current 16 cents excise tax on cigarettes. Quite simply, an extension of this tax could mean the end of many family farms in Kentucky.

Kentucky is the largest producer of burley tobacco. The average size farm in Kentucky is 144 acres which is extremely small when compared to the national average size farm of around 450 acres. Most of the 101,000 farms in the state are family operations which has been passed down from generation to generation.

It is not unusual to have a single farm supporting more than one family. I have been asked how can such small farming units support its operators, and the answer is simple—tobacco. Tobacco is raised on only 2 percent of the land, but it brings in over ⅓ of the total gross income on the farm. Tobacco is one of those unique commodities that requires over 300 hours of labor per acre, most of which is hand labor. Raising tobacco is a family endeavor that provides the bulk of the net income on the farm, paying the bills. Tobacco is an economic mainstay that is working well, as evidenced by the fact Kentucky has the lowest delinquency rate with Farmers Home Administration of any state.

It is tobacco that allows Kentucky farmers to operate on such a small scale, however; it is because of this crop that Kentucky farmers raise so many other crops. Kentucky ranks surprisingly high in production of other commodities ranking in the top 14 states nationally of such items as soybeans, corn and hogs. Take away the income of tobacco and the agricultural diversity of Kentucky will be abolished.

Kentucky is tobacco and any move to extend, or increase, the doubling of the excise tax will have a substantial negative impact on the economy of Kentucky. According to the U.S. Department of Agriculture, since 1983, when the additional 8 cent tax was imposed, cigarette output fell 4 percent, and has never recovered. For every 1 percent of the market, there are roughly $288 million in retail sales. Therefore, this 4 percent drop caused a total reduction in sales of over $1 billion annually.

There is a grave misconception about just what the effect of this drop in sales means. It does not mean that cigarette manufacturers lost money. Nothing could be farther from the truth. The management of these companies did what any management worth its salt would do—it simply cut costs to maintain profit levels. And one way to reduce costs is to buy more of the cheaper imported tobacco, and less Kentucky burley.

In 1981 and 1982, before the imposition of the temporary 8 cent excise tax squeezed operating costs of the cigarette manufacturers, the companies used 463 and 444 million pounds of domestic burley, respectively. By 1983, only 388 million pounds of domestic burley was used, almost a 17 percent drop. This trend has spelled disaster for the small tobacco farmers who operate the 101,000 family farms in my State alone.

The tobacco farmer in Kentucky simply cannot make it under another year of this tax; 72 percent of Kentucky's tobacco farmers depend on tobacco for at least 50 percent of their gross income, while 76 percent of Kentucky's tobacco farmers have annual net farm income of less than $10,000, with 47 percent having total family farm and off-farm income of less than $20,000. My constituents are very small, family farmers, who are having a tough time making it as farmers. If it weren't for their tobacco crops, they would have to find a new vocation. And that would not be easy since 44 percent of all farmers in Kentucky have less than a high school education.

Failing to allow the excise tax to sunset will only continue to force the cigarette manufacturers to find ways of reducing their use of domestic tobacco in order to maintain profits, which translates into trouble for the Kentucky farmer and the state economy as a whole. Every time we reduce tobacco production by 1 percent in my state, 1,183 jobs are lost, or the total State product declines by about $24 million.

The 8 cent additional excise tax, added in the 1982 Tax Act, was to have been only a temporary revenue-raising measure, and with good reason, too. Not only is the cigarette excise tax a highly regressive tax which conflicts with our very notion of a fair and equal system of taxation, it actually has the unintended effect of increasing imports. As the manufacturers look for a way to reduce costs, they turn to cheaper tobacco produced overseas by countries whose depressed standards of living support very cheap labor. Tobacco is a highly labor-intensive crop, and those areas of the world where labor costs are very low can produce a less expensive crop. It cannot compete with the quality of our domestic crop, but it sure can save the manufacturers money. And, I don't have to tell this Committee what the effect of increasing imports will have on our balance of trade.

This is an inherently bad tax—it is highly regressive and punitive at best. Tobacco is a legal product; cigarettes are a legal product, and as long as they are, the tobacco using American public should not be subjected to taxes designed to discourage their use of such a product. The health groups will tell you that their goal is to produce a smoke-free society by the year 2,000. That may be a legitimate goal for a private interest group, but it is not one that the United States Congress should be helping to achieve through taxation. Congress has an appropriate role to play in providing the public with information on the health effects of smoking. I worked with the health groups during the last Congress to produce a responsible cigarette labeling bill, designed to educate tobacco users about the potential health effects of such products. That was an appropriate form of action for the Congress to take. However, using the tax system, particularly the highly regressive cigarette tax, to further the social aims of a certain group, is neither responsible nor appropriate for Congress.

Congress recognized the regressive nature of this tax and the uneven burden it placed on tobacco users and so provided for the September 30, 1985 sunset. The tax burden from the cigarette excise tax is ten times greater on those with an annual income below $10,000 than on those with income between $50,000 and $100,000. This tax has a much greater impact on low and middle income taxpayers, the very same taxpayers who are currently funding our federal deficit. Any move to aggravate that burden should be seen for the punitive measure it is.

To extend the tax past the sunset date would have a devastating effect on farmers in my state and would fly in the face of responsible tax policy, and the work Congress, and particularly this Committee, is doing to achieve true tax reform. At a time when Congress is looking to simplify the Tax Code and reduce the tax burden on lower and middle income taxpayers, continuing the cigarette excise tax at 16 cents would do the exact opposite. If we are serious about providing tax relief to these income groups, and if we are sincere in our desire to design a tax system that falls evenly on all, then an extension of this tax is the wrong way to go.

The tobacco farmer is being hit from all sides. Congress demanded that the Tobacco Price Support Program be operated at no cost to the taxpayers. Yet, we provided no flexibility in the operations of the program to account for a sudden drop in use. The provision of the no net cost program, you may remember, was to require farmers to pay into a fund to provide for any potential losses to the government that might occur. The result is an increase cost to the farmer of 30 cents per pound, up from one cent per pound in 1982. Congress is now debating significant changes in this program which will require further sacrifices from farmers in order to ensure the long-term stability of the program. Extending this tax will be the straw that breaks the camel's back and may very well unravel the tenuous agreements reached regarding the tobacco program.

As the Chairman knows, there are several proposals for earmarking any extension of the tax for specific purposes. I am opposed to any such earmarking. If today we earmark these funds for the tobacco program, or certain health programs, tomorrow we may decide to earmark them for studying the activities of the snail darter. It is a bad precedent and an unfair one.

The health groups claim that cigarette smoking has cost the taxpayers $3.8 billion through the Medicare and Medicaid programs. Because of this, they suggest we tax tobacco users and earmark a portion of those funds to finance these federal programs. Following that logic, perhaps we should pass a soft drink excise tax to pay for the health costs associated with sugar imbalances, or perhaps an automobile excise tax to pay for the cost of automobile accidents, or perhaps a food manufacturers tax for the health cost of salt in the diet. The unreasonableness of such a policy is obvious, and Congress has never seriously considered allocating health costs to specific industries.

The total actual cost to the federal government of the Medicaid and Medicare programs in FY 84 was approximately $82.8 billion. If tobacco users account for only $3.8 billion of that, then clearly there must be a group responsible for a much larger share of these costs. To burden low and middle income tobacco users with a highly regressive tax on a product they legally enjoy, under the guise of reducing the federal health care costs on other Americans is pure hype. If we really want to allocate federal health care costs to those who receive the services, then let's address the source of the remaining $79 billion in costs under the Medicaid and Medicare programs. To limit the review to only the $3.8 billion allegedly associated with tobacco users points out the true purpose of such proposals—to punish those who won't accept the warnings of the health groups and wish, instead, to continue using a legal product. Well, I can't say I blame the health groups for trying; prohibition didn't work either—perhaps they think burdensome taxation will. The purpose of such a tax is quite simply to reduce cigarette consumption and, to my knowledge, I am not aware of any other area where Congress uses tax policy to force its citizens into a particular social behavior. It appears that some would have "Big Brother" alive and well in 1985.

Mr. Chairman, the doubling of the cigarette excise tax was meant as a temporary revenue raiser. Its effect on the small, family farmers in my state has been hard, but an end was always in sight. To extend this tax would force many of my constituents to sell the family farm which has been their way of life for generations. To extend and increase such a tax would be disasterous, coming at a time when the tobacco farmer is being called on to accept changes in the Tobacco Program and bear a larger portion of its costs. To further earmark such a tax would be punitive only, and would miss by a wide mark the stated goals of such action. As this Committee continues to debate tax reform and deficit reduction, I hope it will keep in mind that the bottom line of any such action is that the Kentucky burley farmer will suffer.

KENTUCKY GOVERNOR MARTHA LAYNE COLLINS
Taxation and Debt Subcommittee of the
Senate Finance Committee
September 10, 1985

Thank you for this opportunity to testify on the cigarette excise tax.

It allows me to relate the ways that extending the 8 cent tax would work a hardship on Kentucky farmers and unfairly limit state governments everywhere as they are compelled by Washington to assume more responsibilities. To extend the tax would also encourage the importing of more foreign tobacco and hence the accumulating of more domestic surpluses.

I must say it would also break faith with the American people. When government sells a tax as a temporary measure, the tax should be temporary. Continuing to impose it on the population after it was supposed to end merely feeds and reinforces any tendency on the part of our citizens to be skeptical about taxes and government.

I have a particular interest in this tax because of the tens of thousands of people in my state who depend on burley tobacco for a substantial part of their income.

In Kentucky we have 101,000 farms, and nearly 80,000 of them produce burley tobacco. Most of these tobacco farmers -- some 72 percent -- count on tobacco for at least 50 percent of their gross sales.

These are not the wealthy farmers conjured up in some analyses and commentaries. Three-fourths of our tobacco farmers have a net annual farm income of less than $10,000; and 47 percent have a total annual family income of less than $20,000.

Tobacco accounts for more than one-half of the total value of all Kentucky crops. So you can see that anything that affects tobacco, affects most of our farmers.

Like farmers elsewhere, Kentucky's farmers are encountering some of the most difficult times since the Great Depression. Even at that, they are carrying their own weight in paying for their federal program in a way other farmers are not asked to do.

This year Kentucky burley farmers are expected to pay 25 cents a pound into the No-Net Cost program.

If the excise tax is not extended, University of Kentucky economists estimate that they can sell an additional 10 to 16 million more pounds of burley. That translates into important income for our farmers during this time when agriculture is undergoing tremendous adjustments in land values, in markets and perhaps in government programs.

When our burley farmers are paying for most of their program, it is unfair to impose the additional burden the excise tax works on them.

What has happened under the tax is that in order to keep profits up, tobacco companies have imported more tobacco. Every pound of this tobacco means one more pound of domestic tobacco in storage.

The loss of income from that one pound affects not only the individual farmers in my state, but also businesses and communities.

Tobacco farmers and farm workers earned some $453.7 million directly from tobacco in 1984. Indirectly, burley generated $1.94 billion in personal income. Every drop of one-percent in the production of burley means a loss of 545 jobs, and a $19.4 million drop in lost income.

Tobacco farmers in every state have cooperated to find a solution to the problem of surpluses. Ending the tax on schedule will enable them to further their efforts more effectively.

It will also give state governments more flexibility in dealing with their own pressing needs. Increasingly, we see Washington placing more responsibilities on the states without the money to fulfill them. This problem is aggravated when Washington eliminates option after option for raising revenue at the state level.

Maintaining the additional 8 cent federal excise tax sharply limits the states' ability to raise more money in this fashion. I do not look with favor on this tax, but do favor allowing individual states the opportunity to make the choice if they feel it is necessary. If they are to have that choice, this tax must not be extended.

In conclusion, let me say that in Kentucky when we're talking about farms, we're talking about hundreds of communities where the vitality of the schools, banks, businesses, churches -- all depend on farm income. These communities are experiencing difficult times. To extend this tax, will make them even more difficult.

Thank you.

STATEMENT OF EDWIN SUTTON

Presented to
Committee on Finance
Washington, D.C.
September 10, 1985

Mr. Chairman, Members of the Finance Committee:

My name is Edwin Sutton, president of the Kentucky National Farmers Organization. My two sons and I own and operate a 700 acre tobacco/livestock farm in Garrard County, Kentucky.

We are all aware of the problems facing agriculture today, all of which have been brought about by low farm prices, high costs of production that leads to deterioration of farm assets and farm foreclosures. We are in the worst economic crisis since the depression of the early thirties. Publication of the parity ratio index recently by the U. S. Department of Agriculture established an all time low. The parity ratio reached 52 in May of this year, and this was the lowest ever. It only dropped to 53 in June of 1932.

Since I am a tobacco producer and our main cash crop in Kentucky is burley tobacco, we are here to discuss the possibility of removing some of the excise tax on tobacco products.

In 1982, Congress added an additional tax of 8 cents per pack on cigarettes with the provision that it would expire on October 1, 1985. Following the imposition of this tax, cigarette consumption dropped 7%. While other factors contributed to the decline in cigarette consumption, I am convinced that the additional excise tax was the major factor causing the decline in cigarette consumption.

I believe this is an unfair tax, because when the tax was increased in 1982, the 55 million people who choose to smoke were singled out and a tax imposed on them. I think this is unequal taxation.

The large decline in cigarette consumption impacts directly on income from tobacco. It is estimated that the value of the tobacco crop declined by 1 billion dollars in 1983. Part of this decline was due to adverse weather, but a large part of the decline in farm income can be attributed to lower consumption of tobacco products caused by increased excise taxes.

In 1983, the 97th Congress indicated to the American people that the cigarette tax would be a temporary measure. In addition, a major theme of the 1984 presidential and congressional campaigns was in opposition to a tax increase of any kind. One thing is clear--refusal to allow the cigarette tax to expire on October 1 is scheduled as a tax increase and the increase of this tax will have a direct impact on the producer of tobacco.

During the past several months, all segments of the tobacco industry have been working together to develope a program to cope with declining demand for tobacco products, excess supplies of tobacco in storage, and a declining share of the world market for tobacco. If this tax is allowed to expire I believe the demand for our tobacco products will increase.

In my opinion, people will continue to use tobacco in some form. Taxation will increase cost and companies will look elsewhere for cheaper tobacco to cheapen the cigarette. Our market will further decline and more farmers will have to leave the farm.

In conclusion, I think it has become a sad time in the history of agriculture that due to low farm prices, high cost of production, and high taxation that we cannot pass our land on to our children because they cannot profit enough from the production off the land to meet expenses, have a comfortable living and educate their children as we have known and enjoyed in the past. Your committee probably cannot do anything about low prices or high production costs, but you can do something about high taxation. I therefore strongly recommend that the 8¢ excise tax on a pack of cigarettes be allowed to expire on October 1, 1985.

Thank you very much for the opportunity to appear before this Committee.

Senator **Chafee**. Let me just ask you one question. I don't understand the relationship between the imported tobacco that you mentioned on page 4 and this tax. It seems to me that, if the imported tobacco is cheaper, as you mentioned, then regardless of this tax I would think your cigarette manufacturers would be turning to it—as the cheaper source.

Senator **Ford**. They are turning to the imports, and they are not buying domestic. So, it is exactly what we have been talking about and what is before the Congress today—imports. We are transferring 3,500 jobs per day to foreign countries, and so, every time you put the tax on a domestic product, you are forcing our manufacturers to go overseas where the quality of life is much lower and the cost per day for labor is much lower, but the quality is much less. Mr. Chairman, you are doing another thing as you transfer jobs overseas and you eliminate our small farmers in Kentucky. You are creating a position where the farmers will vote this program out. When you vote this tobacco program out, you lose the quotas. Then every farmer can grow all the tobacco he wants to, sell it for any price he can get for it. Then the price of cigarettes will come down. And if the health groups think they have problems today, wait until cigarettes get cheaper, and then they will really have a problem. They are opposed to imports—the health groups are—because we have pesticides and chemicals on the tobacco coming into this country that we do not allow our American farmers to use. So, this tax, Mr. Chairman, even though it may seem small, is having a devastating effect both on domestic production and the import of tobacco and the health issue of this country.

Senator **Chafee**. I see Senator Warner has arrived. Senator, won't you come right up to the table?

Senator **Warner**. Yes. I want to follow on with that answer. My distinguished colleague mentioned quality, but the inferior tobacco that is imported into this country, with the pesticides and chemicals on it and so forth, is just going to be detrimental to the health of the people of the United States.

Senator **Ford**. It surely is.

Senator **Chafee**. I don't want to belabor this, but the tax applies to all cigarettes that are sold. So, regardless of whether it is an import or it is a domestic, the same tax applies.

Senator **Ford**. But, Mr. Chairman, you are missing the point. If you reduce the consumption, which you have already done by 4 points, which is $1 billion in retail sales annually, the manufacturers then—when they have that reduction in retail sales—will maintain their profit. As they should, as I said earlier, any CEO worth his salt is going to try to maintain that profit. So, when he loses in retail sales, the manufacturer reduces the expense of the company by purchasing imports. So, from the date you put the tax on until today, you have lost $1 billion in annual retail sales or 4 percent. Now, that 4 percent is being made up by imports.

Senator **Chafee**. Wouldn't the manufacturer, regardless of whether he is selling a lot of cigarettes or a few cigarettes, go for the cheapest source of supply?

Senator **Ford**. Sure, and that is imports.

Senator **Chafee**. So, it seems to me that whether he is selling a lot of cigarettes, as perhaps was the situation before the tax, or not a lot of cigarettes, the 4 percent reduction——

Senator **Ford**. But if the price is the same, then they will go for quality. And that is what we have: quality. So, now we are sacrificing the domestic farmer. We are sacrificing quality. We are bringing in imports that have pesticides on it that this country will not allow our farmers to use. And so, the 8 cent tax, as I said, was small in comparison with the overall picture, but it is devastating to an industry.

Senator **Chafee**. I see. Let's do this. If you can stay a minute, Senator Ford, why don't we take Senator Warner's statement now? Can you stay?

Senator **Ford**. Yes. I will be glad to stay, Mr. Chairman. Let me just make one other point. The 8 cents has created additional problems. Even the health groups agree to limit imports. Now, if we continue with the taxation of this product and the farmers decide that they can't continue and they vote the program out, then the very item the health groups want to keep is the quota system which limits the production. Now, if that quota system goes out, and the farmers will have an opportunity to do that in February of next year, then the farmers in this country will grow all the tobacco from fencerow to fencerow, as much as they want, take any price they can get for it, and then the cost of cigarettes is bound to come down. Health groups understand this, and I think they are in a dilemma. They want to use the tax to reduce the consumption, but they didn't foresee the role imported of tobacco in this debate. So, if we are not very careful, you are going to be swimming upstream, so to speak, against the very concerns of the health groups. That is fine, but it is devastating to the farmer. So, the health groups have to look at this one real hard before they make a decision to support the increased taxation.

Senator **Chafee**. Senator Warner, do you have a statement you would like to make now?

Senator **Warner**. Mr. Chairman, I do.

Senator **Chafee**. First, let me welcome you here.

STATEMENT OF HON. JOHN W. WARNER, U.S. SENATOR FROM THE STATE OF VIRGINIA

Senator **Warner**. Thank you, Mr. Chairman. It is basically a prepared statement. Much of the testimony has been covered by Senators Helms and Ford because we work on this problem together, and I would be happy to submit it for the record and thereby enable the members of the distinguished committee to propound questions. I think that might be helpful. I would want to make one observation, Mr. Chairman. I did a little research about your views before the House Ways and means Committee in which you advocate abrogating the agreement and doubling the tax to 32 cents a pack, earmarking the 16-cent increase to the Social Security Hospital Insurance Trust Fund. With all due respect, I urge the committee to act with extreme caution in this area, and I think the fundamental thing here is a sort of a pledge that the Congress made to the people of the United States and the industry that this thing would be sunsetted. And now, it concerns me greatly that the Congress' credibility is going to suffer.

Senator **CHAFEE**. Do we have your statement? I don't see it here.

Senator **WARNER**. It will be produced momentarily.

Senator **CHAFEE**. That's fine.

[The prepared written statement of Senator Warner follows:]

STATEMENT OF SENATOR JOHN WARNER

Mr. Chairman, I appreciate this opportunity to appear before you and the subcommittee on behalf of my constituents who rely so heavily on the tobacco industry for their livelihood.

In 1982, when Congress doubled the tax on cigarettes, Congress also agreed that this tax increase would be short-lived—that the eight cent increase would be allowed to sunset on October 1, 1985.

October 1, 1985 has been long awaited by the tobacco industry and bv several state governments as well.

Fifteen state legislatures have passed laws increasing the state tax by eight cents a pack contingent on the scheduled sunset.

However, now that the date is at hand, some members of Congress are calling for an abrogation of that agreement.

Indeed, I have read your statement, Mr. Chairman, before the House Ways and Means Committee in which you advocate abrogating the agreement and doubling the tax to 32 cents a pack, earmarking the 16 cent increase to the Social Security Hospital Insurance Trust Fund.

With all due respect, I urge the Committee to act with extreme caution in this area.

Indeed, if Congress repudiates its previous agreement and disallows the sunset, a serious mistake will have been committed.

My distinguished colleague from North Carolina has just outlined the harmful effects this tax has had on the beleaguered tobacco industry nationwide.

Therefore, I will limit my remarks to the industry in Virginia.

Tobacco has great economic importance in my state.

Virginia is second only to North Carolina in value of manufactured tobacco products.

Tobacco is grown in about half of Virginia's 95 counties and 24 independent cities.

It is sold at auction warehouses in ten cities.

A study by the Wharton Applied Research Center of the University of Pennsylvania determined that one out of eighteen jobs in Virginia is generated and supported by tobacco.

This study placed the total number of tobacco related jobs in Virginia at 90,740, paying wages of $1 billion, 193 million, 237 thousand dollars.

In 1983, when the eight cent increase went into effect, the tobacco growers lost one-third of the cash value of their crops.

This is a burden that the tobacco region economy cannot continue absorbing.

Other major employers in the Commonwealth—the textile and footwear industries—are suffering similar declines, reducing employment opportunites for the people of southside Virginia.

Admittedly, there are numerous factors contributing to the economic problems of southern Virginia, but to place additional tax burdens on the most heavily taxed industry in our nation—an industry on which these people must rely for their livelihoods—seems a cruel and harsh measure.

I hope this committee will abide by the agreement Congress made three years ago and allow this tax to sunset as scheduled.

Thank you, Mr. Chairman.

Senator **CHAFEE**. I have no further questions on this subject. Senator Durenberger, do you have any questions?

Senator **DURENBERGER**. No, Mr. Chairman.

Senator **CHAFEE**. Gentlemen, you are eloquent proponents for your constituents. Senator Bradley, do you have any questions of these gentlemen?

Senator **BRADLEY**. No, Mr. Chairman. I don't have any questions.

Senator CHAFEE. All right. Thank you very much for appearing, and we will certainly bear your views in mind. We are grateful for your taking the time to be with us.

Senator WARNER. Thank you, Mr. Chairman, for the opportunity to testify.

Senator FORD. Thank you, Mr. Chairman and members of the committee.

Senator CHAFEE. Now, we have a panel consisting of Mr. Neumeyer, Mr. Maxwell, Dr. Schwarz, and Mr. Knott.

Senator DURENBERGER. Mr. Chairman, while they are coming up, could I possibly make a brief statement?

Senator CHAFEE. Yes. Why don't we all give our statements while these gentlemen are coming up. First of all, let me just say that the medical evidence of the incidence of tobacco-related diseases among users of cigarettes demonstrates the correlation between smoking and increased health care costs. An increased Federal excise tax on cigarettes is a tax imposed on tobacco users for the resulting health care costs they impose on our health care system.

The current excise tax of 16 cents will fall to 8 cents per pack as of October 1 unless Congress does something. I believe it would be a mistake to let the tax fall. In fact, I have introduced legislation which would double the tax to 32 cents a pack. This would continue the tax at 16 cents until January and then increase it to 32 cents, with the extra 16 cents earmarked for the hospital insurance trust fund, Part A of the Medicare Program.

According to the Coalition on Smoking and Health, in 1981, as I mentioned earlier, cigarette smoking accounted for $13 billion in medical care costs and $25 billion in lost economic opportunity. Cigarette smoking costs taxpayers $3.8 billion through Medicare and Medicaid Programs. So, clearly smoking imposes a burden on society. The health care costs of smokers are subsidized by those who don't smoke. It is reasonable, therefore, to ask smokers to contribute additional funds toward the health care programs that are of assistance to them.

The recognition of the health care demands smokers make on health care programs is especially important when we look at the Medicare Program. The hospital insurance trust fund is still in trouble. Although the actuaries disagree as to the exact projected date of the bankruptcy of the program, few will disagree with the proposition that measures must be taken to ensure its long-term viability. By the year 2000, only 15 years away, the number of people over age 65 in the United States will increase by 18 percent. Those over 85 will double. These figures are nothing compared to what will happen in the next century. In fact, the figures we were using, I believe, are conservative.

These statistics leave us with the clear and unequivocal evidence of the need for prompt, effective, and above all careful action. We know what dragging our feet now will mean for the future of the health care system for the elderly. It will be bankrupt. While an increased tax on tobacco earmarked for the trust fund may not ensure the trust fund will remain solvent, it certainly will help.

Now, yesterday I received a copy of a report released by Harvard University's institute for the study of smoking behavior and policy, which contains the proceedings of a conference on cigarette excise taxes. This report clearly shows that allowing the tax to fall could induce hundreds of thousands of today's teenagers to take up smoking in the coming years. And I recommend this report to all of those interested in the issue of the excise tax.

So, I will submit the balance of my statement for the record. And I am delighted that we have this list of witnesses before us. Senator Durenberger, if you have a statement, now would be a good time to give it.

Senator DURENBERGER. Mr. Chairman, I thank you for the opportunity. Most of us were here for the discussion on the debt ceiling, and I know it isn't popular to suggest that anybody here ought to swim up against a $2 trillion tide, but I would like to start by restating my position in the past on Federal excise taxes on tobacco, alcohol, et cetera. I suspect I am one of the only nontobacco, nonrye, nonbarley, or nonalcohol-producing State Senators who has consistently voted against Federal excise taxes for tobacco and alcohol. I know you are going to hear today from a lot of witnesses who quote all of the public opinion polls that up to 79 percent of the people in the country say: Tax tobacco. Tax tobacco. So, it is going to be very hard for this committee to resist the notion that we can solve the deficit problem simply by passing a tobacco tax. In reality that isn't going to do it. It's $1.7 billion drips into a $2 trillion bucket, and that isn't going to make any difference.

I credit you, Mr. Chairman, with raising the issue with your bill, and lots of other people have done it also. I think we ought to pay a little more attention to how we use tax policy in this country to achieve certain ends. I feel strongly that excise taxes ought to be left to the State. Now, that doesn't mean I wouldn't support a national consumption tax, a broad-based consumption tax, that is.

In my interest in the intergovernmental system, and Senator Symms spoke to it earlier in terms of education, I feel very strongly that the 50 States need some access to some source of taxation that is relatively flexible and does deal with consumption. History indicates that the excise tax is it. History has also indicated to us that Federal policy has been to get out of the excise tax business, not to go into it. It seems to me we are going into it today largely because of the deficit.

Certainly, that was the tougher reason for going into it. Now, we have before us a panel that will suggest to us that there are other reasons, and I think we need to pay attention to these reasons as we deal with the appropriate role for a national tax policy. If we want to take over another base of taxation from the States, we need to remember that Federal aid from Federal revenues as a percentage of State and local spending has declined over the last 6 years from 31.7 percent in 1980 to 21.8 percent in 1986. So, we at least need to get over that cliff. We are making a commitment to continue to reduce not only Federal aid to State and local governments, but to deprive State and local governments of access to certain forms of taxation such as the excise tax. So, keep that in mind first.

And second, keep in mind the potential progressivity, regressivity of this kind tax. That is an area that leaves me a little bit uncomfortable. I have seen studies that say 21 percent of teenagers either quit smoking when a 16-cent tax is imposed, or they don't start. Eight percent of adults react the same to the tax. I have seen that. I believe it. But let me tell you, I don't think that is equitably distributed across income categories in this country, and I think we need to be sensitive to that fact. I don't know who will prove it, but maybe some of our panelists can discuss that. Blue collar women in particular seem to be smoking a lot more in comparison to others.

I see the white collar figures going down and the blue collar figures averaging, but maybe somebody here today can help us with that one. Regarding health effects, I have no doubt about the health effects of smoking. None of our senatorial witnesses here on behalf of the tobacco industry would take on that issue. I don't think anybody denies it. The figures are all very clear. Yesterday, we had a subcommittee hearing on the 335,000 Americans who are dying of asbestos-related problems, and that is related to smoking also. The question gets to be how are we going to take on that problem.

The deficit has given a lot of people the opportunity to say that we should raise the cigarette tax because cigarette smoking causes $40 billion a year worth of health-related problems. I have said this many times before as a semiexpert on Medicare. You are going not to solve the health-related problems from smoking just by lumping another $1.7 billion into a Medicare trust fund. That is not going to solve the problem of tobacco-related illnesses, however. So, recognizing the inevitability, that 79 percent of the people of this country are going to persuade you, Mr. Chairman, that we have to maintain that 16 cents, I am trying to deal with how we could spend that money so that it had some impact on the adverse health consequences of tobacco consumption.

I have proposed several bills, including one today, Mr. Chairman, suggesting that we target 8 of those 16 cents to health promotion and disease prevention. I have to say that I fairly strongly oppose your position and that of AARP that we should put it into the Medicare trust fund. We, with the help of many others, have taken a lot of action in the last few years that has saved the Medicare trust fund. But it seems to me that putting cigarette taxes in the Medicare trust fund is going at it the wrong way. That is sort of dumping the money in a bottomless, non-means-tested pit that isn't going to necessarily produce any less smoking on behalf of the elderly. However, if we committed those resources, particularly if we let State legislatures commit those resources to their specific needs for health promotion and disease prevention, I think we would get something for that the money that is going to hurt these tobacco farmers in Kentucky, North and South Carolinas, Virginia, and other places.

And I just don't think there is any point in putting 1,000 tobacco farmers out of business unless we are also going to get some positive feedback. Our current expenditures are $110 billion a year for the after-effects of smoking and accidents and diseases, and only $1 billion goes into health promotion. I would like to hear what some of these witnesses have to say, because I think it is really important that we try to figure out a way that, if we are going to do this tax—which I still think ought to be left to the States. I really think we ought to make sure that the money goes toward some health promotion, wellness, and disease prevention. If we fear that this means that we are going to build up a large national tax that we can never undo, I would just say we can always work State buy outs on that kind of tax. Once we have solved the so-called deficit problem and once people are used to using a cigarette tax for health promotion and disease prevention, then we can have the States buy us out.

If we have a 16-cent Federal tax, we can have a provision where the States buy us out by enacting their own taxes, which would go into health promotion, wellness, and disease prevention.

Mr. Chairman, I appreciate your letting me take this much time to explain it. Having looked over the various statements before us, I can see you will have to be a Solomon to figure out exactly how to do this tax. I thought I would just add another dimension to the subcommittee's discussion of a very important issue.

Senator CHAFEE. Thank you for a very interesting observation. If you turn over 8 cents to the States for promotion—for wellness promotion, would it include more tangible services than simply education?

Senator DURENBERGER. I am talking about the kinds of programs that are currently in the maternal and child health block grant, for example, and the kinds of programs that are funded by the alcohol-chemical dependency kinds of programs. I am not talking about just education although that is important, particularly for teenagers, but there are these other programs that relate to pregnancies and the young in general.

Senator CHAFEE. Thank you. Senator Bradley.

Senator BRADLEY. Thank you very much, Mr. Chairman. I will try to make this brief because I know we do want to hear from the witnesses. If you will recall, a couple of months ago when we considered the budget, I offered an amendment that would have prevented a major increase in out-of-pocket costs to senior citizens under Medicare, and would have kept the cigarette tax at 16 cents instead of having it drop back to 8 cents. I did this because I felt it was just incredible that, at the same time we would be reducing taxes on tobacco, we would be demanding that senior citizens pay considerably higher premiums for their health care. That amendment failed by two votes on the Senate floor. The budget resolution that we are now having a hearing on does not assume a major increase in the part B provision. It is not contemplated under the final budget resolution. We have achieved half of what the amendment set out to do. The second half was to keep the cigarette tax at 16 cents, and that is what I hope we will be able to do in the course of these hearings and our markup, for all of the reasons that both Senator Chafee and Senator Durenberger have enumerated. Whether the money is earmarked to the Medicare Trust Fund or whether it is spent on health promotion is the second half of the question. Let's at least keep the cigarette tax at 16 cents.

I also, speaking personally, will want to ask the witnesses whether we shouldn't consider a tax on smokeless tobacco. Now, I admit I didn't play baseball and didn't spit that tobacco out as I would from the batter's box, but it seems to me that there is a correlation between use of smokeless tobacco and a variety of diseases; and I will want to explore that with members of the medical community to see if indeed we shouldn't expand the tax to cover smokeless tobacco as well.

Senator **Chafee**. Thank you very much. As regarding the smokeless tobacco, Mr. Michael Kerrigan, who is to be on the panel after this, from the Smokeless Tobacco Council, is appearing with former President Carter at a seminar of some type they are conducting in Georgia. President Carter called me yesterday and asked me if I could arrange for Mr. Kerrigan to come at a subsequent time. I readily agreed, and so Mr. Kerrigan from the Smokeless Tobacco Council will be back here at another time. The questions for the health people will be fine Senator Bradley, but I just wanted to point out that the Smokeless Tobacco Council will be represented at a subsequent hearing that we will arrange at a mutually convenient time.

I would also like to make just one other point. in connection with the excise tax, when Congress doubled the tax on cigarettes from 8 cents to 16 cents, it was pointed out in a book by Kenneth Warner called "Cigarette Taxation, Doing Good by Doing Well," that the doubling of the excise tax caused one and a quarter million adult Americans to stop smoking, and one-half million teenagers to stop or not start smoking because they are price-responsive young people. In other words, when something costs more, they don't do it. Teenage smoking decreased by 14 percent, and adult smoking decreased by 4 percent. There are other ramifications to this besides what you do with the money you get. There is also the side of it that when you increase the tax, you have fewer smokers.

Senator **Bradley**. Mr. Chairman, if you look at what that tax represents as a percent of the price of the pack of cigarettes, it might not be high enough. In 1919, the cigarette tax was 6 cents. In 1951, it was 8 cents. And in 1951, that 8 cents represented 37 percent of the price of a pack of cigarettes. Now, it is 16 cents and it is only 20 percent of the price of a pack of cigarettes. So, I think we also ought to look at whether it is high enough to achieve the objective of reducing smoking.

Senator **Chafee**. All right. Let's begin with the first panel. Now, gentlemen, we have odd rules in the Senate. Senators can talk indefinitely, and witnesses are limited. [Laughter.]

And that seems unfair, but since we set the rules, that is the way we have done it. Now, we have 3 witnesses on this panel, 4 on the next, and a total of 11 witnesses, and we are going to be out of here in the next couple of hours. So, please keep your remarks to 5 minutes, and we will help you keep them to that. Mr. Neumeyer, we are glad you are here. Why don't you go ahead?

STATEMENT OF DAVID B. NEUMEYER, ASSOCIATE DIRECTOR, COALITION ON SMOKING OR HEALTH, WASHINGTON, DC

Mr. **Neumeyer**. Thank you, Mr. Chairman. My name is David Neumeyer. I am the associate director of the Coalition on Smoking OR Health, which was formed in 1982 by the American Cancer Society the American Lung Association, and the American Heart Association to better educate Members of Congress and Federal administrators on the hazards of cigarette smoking.

I am testifying today on behalf of the coalition and a number of national organizations who are working with us to raise the cigarette tax this year, including all the witnesses at this table, and in addition, other groups such as the children's defense fund, the National Board of the YWCA, and the National Association of Elementary School Principals. There is a long list in the beginning of my testimony, and we total 43 national organizations, with a membership of 30 million volunteers and members. The reason that we are working this year to prevent the tax from falling and to raise the tax to 32 cents, which is the level that it would be had it been adjusted for inflation since 1951, is that taxes help raise prices, and prices deter people, especially kids, from taking up smoking.

Before I go any further, Senator, I would like to thank you for your interest and leadership in this issue. Last year in the Deficit Reduction Act of 1984, the tobacco industry was successful in beating back an attempt by the House to even impose a moderate tax from 1985 to 1988 of 12 cents. The Washington Post commented in an editorial: "The tobacco lobby walked off with the prize for the biggest and most undeserved tax break of the year." This year that has changed. We have six bills in Congress to raise the tax to 32 cents, a variety of bills to set it at other levels and to make positive use of the funds, and your bill, S. 874, is one of those 32 cent bills.

We need to thank you for your leadership on that, and also certainly thank Senator Bradley for his work on the budget amendment. As he knows, it was a close vote. I think he had a majority at one point before the names were written down. We also thank Senator Durenberger for his interest in making use of the 16-cent level, which was a hard decision for him to swallow, considering Minnesota's interest in the funding for a progressive use of the funds for health education. Because of leadership of members like you, the tobacco industry is now fighting an uphill battle in trying to preserve the tax break it thought it had won last year. The House Ways and committee voted in July to extend the 16 cent level, and the Finance Committee will vote on the issue next week.

My written testimony today has five themes which I will just touch on briefly right now. There is widespread public support for raising a tax. A decrease in the tax and the price of cigarettes will encourage teenagers to take up smoking, while an increase in the tax will discourage them from taking up smoking. The tax is an excellent source of revenue. The tax does not have an unfair impact on the poor, minorities, and the elderly, and I should mention, on tobacco farmers, despite Senator Ford's statement: Imports do not go up because of the excise tax. We found that when TEFRA raised the tax 8 cents in 1982, the companies passed on that increase immediately at the wholesale level to consumers. In addition, the companies do not hesitate to raise prices on their own anyway. The New York Times, in a business section article last January, indicated that the companies tend to raise wholesale prices by an average of 8 to 10 percent a year. So, they are raising their own prices just as well as Congress is helping them to do. And finally, the real tax burden on cigarettes has dropped dramatically since 1951, as Senator Bradley mentioned.

I would like to mention also that, concerning the cost of smoking in our society, the numbers which we have currently available are really from 1980 data. We know that the Office of Technology Assessment has been asked by Representative Pete Stark to prepare a new report on the costs of smoking to our society. We expect that shortly and it is expected to have much higher numbers.

I would like to concentrate, however, on the health effects of smoking. There is no question that the cigarette tax affects smoking behavior. You will hear that very well today, particularly from Dr. Kenneth Warner. There is no question that there is wide public support for raising the tax. As indicated in my testimony, public opinion polls conducted by the Yankelovich organization last year indicated that 77 percent of registered voters saw a tax increase as the best means of closing the deficit. This year the Gallop organization reaffirmed that 75 percent of the public did not want to see the tax go down. And as I mentioned, there are 30 million members and volunteers working with us in an ad hoc group to raise the tax this year.

Finally, there is no question about the deadly and enormous impact of cigarette smoking in our society. 350,000 Americans will die this year because of cigarette smoking. I read recently that 1,400 Americans have died this year in airline disasters. That is not even 2 days, worth of cigarette deaths. As you know, Senator, smoking is the leading cause of lung cancer, emphysema, chronic bronchitis, heart disease in our country and causes stillbirth, miscarriage, and birth weight deficiencies. Mr. Chairman, the case here is very simple. Cigarette tax raises prices, which saves lives by deterring people from taking up smoking. Congress should be doing all that it can to raise, not to lower, the tax. Thank you very much for inviting us to testify.

TESTIMONY OF DAVID B. NEUMEYER

Mr. Chairman and members of the Committee, my name is David B. Neumeyer , I am the Associate Director of the Coalition on Smoking OR Health, and I am testifying today on behalf of the Coalition and its member organizations, the American Heart Association, the American Lung Association and the American Cancer Society. I am also testifying on behalf of the American Association of Retired Persons; the Association of State and Territorial Health Officials; the American Medical Association; the Children's Defense Fund; the American College of Cardiology; the American Society of Internal Medicine; the National Perinatal Association; the American Association for Respiratory Therapy; the American College of Osteopathic Pediatricians; the Center for Science in the Public Interest; the American Academy of Otolaryngic Allergy; the National Association of Elementary School Principals; the Terry Gotthelf Lupus Research Institute; the American Academy of Allergy and Immunology; the Asthma and Allergy Foundation of America; the American Association of Dental Schools; the American Medical Student Association; and the National Board of the Young Women's Christian Association (Y.W.C.A.) of the U.S.A.

The Coalition was found in early 1982 by the American Lung Association, the American Cancer Society, and the American Heart Association to bring smoking prevention and education issues to the attention of legislators and other governmental officials. It also serves as a public policy project with the National Interagency Council on Smoking and Health, an organization backed by twenty-four private health, education and youth leadership organizations. The Coalition on Smoking OR Health, the organizations I have listed, and the majority of American public strongly oppose any decrease in the federal cigarette excise tax, and urge you to increase the tax.

In my testimony today I would like to focus on five points. First, there is widespread public support for preventing the cigarette excise tax from falling to its 1951 level of 8 cents per pack and to increasing it to 32 cents, the level it would have been had it been adjusted for inflation since 1951. Second, any action on the cigarette excise tax will affect cigarette consumption, especially among our young people; a decrease in the tax and the overall price of cigarettes will lead to an increase in consumption among teens, while an increase would be a positive step in providing teens the necessary incentive not to smoke. Third, the cigarette excise tax is an excellent source of much needed revenue for the federal government, a source of revenue needed to offset the drain on the federal treasury caused by cigarette-related Medicare and other health related expenses, including the expense of providing the American public with information on the health effects of smoking. Fourth, the cigarettes tax does not have a unfair impact on the poor, minorities and the elderly. Fifth, the tax on cigarette is not unduly burdensome. In fact, the real tax burden on cigarettes has dropped dramatically since 1951 even when state tax increases are concerned.

I. Use of the Cigarette Excise Tax to Reduce the Federal Deficit has Widespread Support:

Support of the American public for an increase in the cigarette excise tax could not be more apparent. Time magazine reported on February 20, 1984, that in a poll by Yankelovich, Skelley and White, 77% of registered voters support an increase in the excise tax as the best means of reducing the federal budget deficit. On June 18, 1985, the results of a Gallup poll were announced showing that 75% of the American public opposes an decrease in the current 16 cent excise tax level, and only 18% of those polled favor letting the tax drop.

Thirty-nine national organizations in addition to the Coalition on Smoking OR Health have explicitly endorsed and adopted the goal of increasing the cigarette excise tax to 32 cents this year. These groups represent almost 30 million Americans covering a broad cross section of the American public. Included in those groups is the Association of State and Territorial Health Officials, the American Medical Association, the American Association of Retired Persons, the American Public Health Association, the National Board of the YWCA, the United Methodist Church's Department of Human

Welfare, the Children's Defense Fund, the American Diabetes Association, the American Academy of Pediatrics, the American Nurses Association, the other organizations listed at the beginning of my statement, and many others.

The six major tobacco companies have paid for a letter writing campaign to oppose a tax increase, but these letters do not represent the opinion of the vast majority of Americans. The results of the polls and the members of the organizations that I have just described do represent the opinion of the majority of the American people, and the people want to see this tax increased.

II. The Cigarette Tax Directly Affects Cigarette Consumption and the Future Impact of Smoking In Our Society

An increase in the cigarette excise tax will do several admirable things for the well-being of the United States. First and foremost, tax increases help raise cigarette prices, and higher prices deter people, especially teenagers, from taking up smoking. Economic data and studies indicate that a 10% increase in the price of cigarettes will cause a decline in smoking among adults of 4% and among teenagers of 14% primarily by deterring people in both age groups from taking up smoking. These studies have been corroborated by the United States Department of Agriculture, which has stated that the 1982 increase in the excise tax from 8 cents to 16 cents a pack was the primary cause of a 5% decline in American cigarette consumption from 1982 to 1983. The National Institute on Drug Abuse also reported a 8.5% decline in smoking among high school seniors from the Spring of 1983 to the Spring 1984, and we believe that the reason for that decline was the increase in prices caused by the excise tax.

Dr. Kenneth Warner, the Chairman of the School of Public Health at the University of Michigan and a witness here today, has just completed a major study of this issue. Dr. Warner has estimated that an increase in the cigarette excise tax to 32 cents a pack would produce a 21% decline in smoking by teenagers and a 6.8% decline in smoking by adults. This decline in the number of smokers and the number of cigarettes consumed will have long term benefits to our society in the form of better health, reduced health care costs, and an increased number of non-smoking role models for the next generation of teenagers. An 8 cent price decrease caused by the sunsetting of this tax, however, would cause an 11.9% increase in smoking by teenagers and a 3.6% increase among adult smokers, according to Dr. Warner. What does this mean in real numbers? Dr. Warner projects that an eight cent decrease in the excise tax will result in an increase in nearly one-half a million more teenager smokers and over one million more smokers between the ages of 12-25. Similarly, an eight cent increase in the tax will result in approximately 432,000 fewer teenage smokers and nearly one million fewer smokers between the ages of 12 and 25 years of age. An increase of the tax to 32 cents as we advocate will result in a decrease in approximately 825,000 fewer teenage smokers and over 1.9 million fewer smokers between the ages of 12 and 25 years of age. To the extent that cigarette companies do not lower prices in response to a reduced tax, Congress will simply be transferring millions of dollars from the federal Treasury into tobacco company profits. Given these choices, Congress should and must choose to improve the health of our children by raising the tax.

III. The Cigarette Excise Tax Generates Revenue for the Federal Treasury Needed to Offset the Costs of Smoking to the Federal Government:

The revenue currently generated for the federal Treasury by this tax, according to the Department of the Treasury, is approximately $5 billion per year. The Office of Tax Analysis in the Office of the Secretary of the Treasury has estimated that an increase in the tax to 32 cents a pack would generate $8.8 billion per year in revenue. The Joint Committee on Taxation has estimated that the revenue generated by 32 cents a pack would range from $6.5 to $7 billion a year. These sums could provide substantial assistance to the Treasury at a time when we face budget deficits over $200 billion. By contrast, a drop in the excise tax as currently scheduled to 8 cents a pack would drop revenues to $2.5 billion a year.

This substantial income could be used to reduce the deficit, or as suggested by Senator Chafee and a number of organizations including the American Association of Retired Persons, it could be used to assist the Medicare system for smoking-related costs. Your bill, Mr. Chairman, would raise the tax to 32 cents per pack and devote half the revenue to Medicare, while Senator Heinz has introduced a bill to keep the tax at 16 cents and give Medicare an equivalent portion. Senator Durenberger expects to introduce a bill this week maintaining the 16 cent tax and devoting half the revenue to a block grant for health promotion by the states, and Representative Edward Roybal's bill would hold the tax at 32 cents and use part of the revenue to fund Medicaid. Each of these positive uses of cigarette tax revenues would help compensate our society for the annual cost of smoking, which cost our medical care system $13 billion in 1980 including $3.8 billion for Medicare and Medicaid, not to mention the $25 billion annually lost to our economy due to sick days, lost productivity and lost wages, according to the National Center on Health Statistics. Dr. Gerald Oster, an economist with Policy Analysis, Inc., of Boston, testified before the House Ways and Means Committee in June that reimbursement to society for all these costs would require an increase in the cigarette tax to $3.00 a pack, and reimbursement for the medical costs alone would require an increase in the tax to 30 cents a pack. It is only fair and appropriate that smokers begin to shoulder more of the cost which they impose upon society, and that children be deterred from taking up smoking by the price increases this tax increase would cause.

After careful study, the Advisory Council on Social Security recommended last year that federal excise taxes on alcohol and tobacco be increased, with the increased revenue to be earmarked to the Medicare Hospital Insurance Trust Fund. The Council based this recommendation on the "demonstrated corrolation between the use of these products and increased health care costs." We strongly believe that Congress should seriously consider this appropriate use of funds for the Medicare system.

IV. The Cigarette Tax Is Not Unfair to the Poor, Minorities and the Elderly

One objection to raising the excise tax is that the tax is allegedly unfair because it affects the poor, minorities and the elderly more than other groups. Research by Professor Jeffrey E. Harris of the Massachusetts Institute of Technology indicates, however, that low income Americans smoke less than middle income Americans. Professor Harris also finds that older Americans, who make up a sizeable fraction of the low income group, have much lower smoking rates than the general population, and that in considering the number of cigarettes smoked per day, the actual dollar burden of a cigarette tax hike is greater for whites than for blacks in every income category.

Professor Harris' findings on income and smoking have been corroborated, in addition, by the 1979 Surgeon General's Report on Smoking and Health. That report documented that smoking rates among males are highest among middle-income levels, while smoking rates for women rise steadily with income. The poorer the woman, the less likely she is to smoke.

The cigarette tax, in summary, falls most heavily on people who are well able to afford it.

V. The Real Burden of Cigarette Taxes Has Actually Declined Since World War II*

Cigarette excise taxes have been a declining share of both federal and state excise tax revenues during the postwar period, despte increases in state excise tax rates. Federal receipts from cigarette taxation increased in absolute terms from $1.2 billion in FY 1950 to $2.5 billion in 1982, but declined as a share of total revenue from 3.2 percent to 0.4 percent and as a share of GNP from 0.5 percent to less than 0.1 percent. As a result of the tax increase in TEFRA, federal receipts from cigarette excise taxes nearly doubled to $4.7 billion in FY 1984, about 0.7 percent of federal revenues and slightly over 0.1 percent of GNP. Federal cigarette excise tax receipts as a share of total revenue and GNP remain below 1950 levels in every year between 1950 and 1975.

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* Data cited is taken from a soon to be published report prepared for Harvard University's Institute for the Study of Smoking Behavior and Policy by Eric J. Toder, Deputy Assistant Director, Tax Analysis Division, Congressional Budget Office.

Although state cigarette excise tax receipts have grown at a faster rate than federal receipts over the same period, they have also declined relative to GNP. State excise tax receipts increased from $0.4 billion in FY 1950 to $4.3 billion in FY 1984. State cigarette excise taxes increased faster than GNP throughout the late 1950s and 1960s, but declined as a share of GNP after 1972 and as a share of total state revenues after 1966.

Inflation has also resulted in a reduction in cigarette taxes in real terms and as a percentage of the price of cigarettes. The federal cigarette excise tax was increased only twice during the postwar period - from 7 cents per pack in 1950 to 8 cents in 1951, and from 8 cents to 16 cents in TEFRA in 1982. This translates into a decline in the tax rate measured in 1984 dollars from 37.5 cents per year in 1946 to 8.6 cents in 1982, followed by an increase to 16 cents in 1984. The federal tax as a percentage of the cigarette price declined from 42.2 percent to 10.7 percent between 1947 and 1982 and now stands at 16.6 percent, about the same rate as in 1975.

On average, state tax rates increased from 12.2 percent of cigarette prices in 1954 to 26.9 percent in 1975, but have subsequently declined to 15.1 percent in 1984. Combined state and federal cigarette excise taxes declined from 49.9 percent of cigarette prices in 1954 to 27.8 percent in 1982, and have since (as of 1984) risen to only 31.8 percent because of the doubling of the federal excise tax rate. The combined excise tax rate as a percentage of price, however, remains lower than the combined rate in effect as recently as 1980.

CONCLUSION

A number of bills have been introduced in this Congress to increase the cigarette tax to 32 cents a pack and to earmark the revenue for Medicare for Medicaid. The Coalition on Smoking OR Health specifically commends the sponsors of these bills, Senator Chafee and Representatives Jacobs, Tauke, Waxman, Oberstar, and Roybal, for their leadership, and urges this Committee to support these bills.

Cigarette smoking kills 350,000 Americans every year. The Surgeon General of the United States has declared that cigarette smoking is the single most preventable cause of death and disease in the U.S., and has cited evidence that unless the smoking habits of Americans change, perhaps 10% of all Americans now alive (or 24 million people) may die prematurely as a result of heart disease caused by cigarette smoking. Smoking is, by far, the leading cause of lung cancer, emphysema and chronic bronchitis. It is a major cause of heart disease. Smoking by pregnant women results in an increased risk of stillbirth, miscarriage, premature birth and birth weight deficiencies. Congress should be doing all that it can to increase, not reduce, the cigarette excise tax, because increases in the tax saves lives and Medicare dollars.

Last year, after passage of the Deficit Reduction Act of 1984, the Washington Post commented in an editiorial that "the tobacco lobby walked off with the prize for the biggest and most undeserved tax break of the year. With cigarette smoking killing and seriously disabling hundreds of thousands of Americans every year, the conferees voted to cut the federal cigarette tax in half. Here's a decision that will cost the Treasury twice: first in the loss of billions in excise tax revenues; second in added billions in Medicare costs which - the irony is monstrous - other parts of the same bill are trying to restrain." On behalf of the Coalition on Smoking OR Health, I urge you to revoke that tax break to the tobacco industry, and to increase the federal cigarette excise tax. By doing so, you will be saving money, and you will be saving lives.

Senator **Chafee**. Thank you very much, Mr. Neumeyer. The next witness is Mr. Maxwell from the AARP. Mr. Maxwell.

STATEMENT OF ROBERT MAXWELL, MEMBER, BOARD OF DIRECTORS, AMERICAN ASSOCIATION OF RETIRED PERSONS, CROSSVILLE, TN

Mr. **Maxwell**. Thank you, Mr. Chairman, and I want to thank the committee for giving us the opportunity to come and speak. I represent the American Association of Retired Persons, and AARP is the Nation's largest organization of older Americans representing over 19 million members, possibly 20 million by Thanksgiving. Mr. Chairman, AARP strongly supports legislation such as your Senate bill 874 which would increase the Federal excise tax on cigarettes and earmark a portion of the generated revenue to the hospital insurance trust fund, Medicare part A. AARP believes that legislation to increase the Federal excise tax on cigarettes would produce several positive effects, including decreasing the health care costs associated with smoking, improving the fiscal stability of the hospital insurance trust fund, and reducing the Federal budget deficit. Smoking is the leading cause of lung cancer, emphysema, and chronic bronchitis, and a major cause of heart disease. The increased incidences of certain disabilities and diseases among users of tobacco products is evidence of high correlation between the use of tobacco products and increased health care costs. According to the National Center on Health Statistics in 1981, the total health and economic costs associated with cigarette smoking did total $41 billion. Of this, nearly $4 billion were costs to the Medicare and Medicaid Programs. Increasing the Federal tax on cigarettes because it decreases smoking holds the potential to reduce these costs. While the precise impact of an increased tax on smoking behavior cannot be exactly predicted, studies to demonstrate that an increase in the cigarette excise tax is an effective incentive to decrease smoking among the population. For example, a study by Dr. Warner, chairman of the School of Public Health at the University of Michigan showed that an increase in the cigarette tax to 32 cents a pack would produce a 21-percent decline in smoking by teenagers, a 6.8-percent decline in smoking by adults. According to the U.S. Department of Agriculture, U.S. cigarette consumption fell 5 percent from 1982 to 1983, largely due to price increases, and in part caused by the increase in the Federal excise tax. Clearly, increasing the Federal tax on cigarettes will improve health and save health care dollars. Although the financial stability of the hospital insurance trust fund is somewhat improved, the hospital insurance fund will still require new sources of revenues in order to assure its future financial health. Surveys of AARP members show a strong preference for higher tobacco taxes as a source of needed additional tax revenues for Medicare. Since users of tobacco products use a significant share of Medicare resources, it is only fair and equitable to ask them to pay the user fee to offset the increased costs to the Medicare Program which result from cigarette consumption. Moreover in this area of budgetary cutbacks, revenues from an increased tax on cigarettes is a preferable alternative to continued shifts in health care costs to Medicare beneficiaries. In addition to improving Medicare's fiscal health, increasing the Federal tax on cigarettes would have a positive impact on the Federal budget deficit. Every 8 cents increase in the cigarette tax yields $1,700 million in additional revenue. The public supports such an increase. As mentioned by my associate, a poll by Yankelovich, Skelley, & White reported in Time magazine in February 1984 showed that 77 percent of registered voters support an increase in the tax as the best means of reducing the Federal budget deficit. A June 1985 Gallop poll reconfirmed these findings; in that poll, 75 percent of the American public opposed a decrease in the current 16 cents excise tax level, 18 percent favored letting the tax drop. Since World War II, cigarette excise taxes have been a declining share of both Federal and State excise tax revenues. A large part of this decline has been the failure of the cigarette tax to keep pace with inflation. The Federal excise tax on cigarettes has been increased only twice during the postwar period, from 7 cents a pack in 1950 to 8 cents in 1951; from 8 to 16 in 1982. With this latter increase scheduled to revert to the 1951 level of 8 cents this October. If the tax had kept pace with inflation, the tax would now equal 32 cents per pack. In this time of tightened budgets, it is difficult to understand the rationale behind allowing a decrease in the cigarette tax, especially given the erosion of the tax's value in real terms over time.

Mr. Chairman, AARP supports your leadership in addressing the issues supporting a need for an increased tax on cigarettes. Cigarette smoling increases health care costs by causing disease and disability. AARP strongly urges the Congress to increase the cigarette tax and earmark a portion of the generated revenue to the Medicare Program. Such a step will improve the general health of the population and the fiscal health of both Medicare and the Federal Government.

Thank you, Mr. Chairman.

Senator CHAFEE. Thank you very much, and we will get back to you with some questions after the testimony from Dr. Schwarz.

[The prepared written statement of Mr. Maxwell follows:]

PREPARED STATEMENT OF ROBERT MAXWELL

Thank you Mr. Chairman for the opportunity to present the views of the American Association of Retired Persons (AARP) on the cigarette excise tax. My name is Robert Maxwell and I am a member of the Association's Board of Directors. AARP is the nation's largest organization of older Americans, representing over 19 million persons.

Mr. Chairman, AARP strongly supports legislation, such as your bill. S. 874, which would increase the federal excise tax on cigarettes and earmark a portion of the generated revenue to the Hospital Insurance (HI) Trust Fund, Medicare Part A. AARP believes that legislation to increase the federal excise tax on cigarettes would produce several positive effects including: decreasing the health care costs associated with smoking; improving the fiscal stability of the HI Trust Fund; and reducing the federal budget deficit.

Smoking is the leading cause of lung cancer, emphysema and chronic bronchitis, and a major cause of heart disease. The increased incidences of certain disabilities and diseases among users of tobacco products is evidence of a high correlation between the use of tobacco products and increased health care costs. According to The National Center on Health Statistics, in 1981, the total health and economic costs associated with cigarette smoking totalled $41 billion. Of this, nearly $4 billion were costs to the Medicare and Medicaid programs. Increasing the federal tax on cigarettes, because it decreases smoking, holds the potential to reduce these costs. While the precise impact of an increased tax on smoking behavior cannot be exactly predicted, studies do demonstrate that an increase in the cigarette excise tax is an effective incentive to decrease smoking among the population.

For example, a study by Dr. Kenneth Warner, Chairman of the School of Public Health at the University of Michigan, showed that an increase in the cigarette tax to 32¢ a pack would produce a 21% decline in smoking by teenagers and a 6.8% decline in smoking by adults. According to the United States Department of Agriculture, United States cigarette consumption fell 5% from 1982 to 1983, largely due to price increases, in part caused by the increase in the federal excise tax. Clearly, increasing the federal tax on cigarettes will improve health and save health care dollars.

Although the financial stability of the HI Trust Fund is somewhat improved, the HI Fund will still require new sources of revenues in order to assure its future financial health. Surveys of AARP members show a strong preference for higher tobacco taxes as a source of needed additional tax revenues for Medicare. Since users of tobacco products use a significant share of Medicare resources, it is only fair and equitable to ask them to pay a user fee to offset the increased costs to the Medicare program which result from cigarette consumption. Moreover, in this era of budgetary cutbacks, revenues from an increased tax on cigarettes is a preferable alternative to continued shifts in health care costs to Medicare beneficiaries.

In addition to improving Medicare's fiscal health, increasing the federal tax on cigarettes would have a positive impact on the federal budget deficit. Every 8¢ increase in the cigarette tax yields $1.7 billion in additional revenue. The public supports such an increase. A poll by Yankelovich, Skelley and White reported in Time magazine on February 20, 1984 showed that 77% of registered voters support an increase in the tax as the best means of reducing the federal budget deficit. A June 1985 Gallup poll reconfirmed these findings. In that poll, 75% of the American public opposed a decrease in the current 16 cent excise tax level; 18% favored letting the tax drop. Since World War II, cigarette excise taxes have been a declining share of both federal and state excise tax revenues. A large part of this decline has been the failure of the cigarette tax to keep pace with inflation. The federal excise tax on cigarettes has been increased only twice during the postwar period - from 7¢ per pack in 1950 to 8¢ in 1951, and from 8¢ to 16¢ in 1982, with this latter increase scheduled to revert to the 1951 level of 8¢ this October. If the tax had kept pace with inflation, the tax would now equal 32¢ per pack. In this time of tightened budgets, it is difficult to understand the rationale behind allowing a decrease in the cigarette tax, especially given the erosion of the tax's value in real terms over time.

Mr. Chairman, AARP supports your leadership in addressing the issues supporting a need for an increased tax on cigarettes. Cigarette smoking increases health care costs by causing disease and disability. AARP strongly urges the Congress to increase the cigarette tax and earmark a portion of the generated revenue to the Medicare program. Such a step will improve the general health of the population and the fiscal health of both Medicare and the federal government.

STATEMENT OF M. ROY SCHWARZ, M.D., VICE PRESIDENT, MEDICAL EDUCATION AND SCIENTIFIC POLICY, AMERICAN MEDICAL ASSOCIATION, CHICAGO, IL

Dr. SCHWARZ. Thank you, Mr. Chairman. I am M. Roy Schwarz, assistant executive vice president for medical, education and scientific policy at the American Medical Association. Accompanying me today is Mr. Michael J. Zarski of the AMA department of Federal legislation. We appreciate the opportunity to testify regarding our support for increasing the Federal excise tax on cigarettes. We share the concern shown by Members of Congress that on October 1, the Federal excise tax on cigarettes is scheduled to drop to 8 cents from the current 16 cent per pack rate.

The AMA not only opposes any reduction in the current cigarette tax rate, but we have joined a coalition of groups supporting an increase in the Federal cigarette excise tax to 32 cents a pack. I might add, Mr. Chairman, that the AMA particularly approves of the approach taken in your bill, and we intend to support your legislation at every stage of the process. When Ben Franklin wrote that nothing is certain but death and taxes, he was not associating one to the other. However, Congress has the opportunity to diminish the number of tobacco-related deaths in this Nation by raising the cigarette tax. Research strongly suggests that for every 10-percent increase in cigarette prices, consumption will decrease about 4 percent among adults and about 14 percent among teenagers. When Congress raised the cigarette excise tax in 1982, cigarette consumption fell by 5 percent. In human terms, reductions in the consumption of tobacco result in fewer instances of smoking-related diseases. We know that smoking is by far the No. 1 cause of lung cancer in the United States. Other cancers as well as heart and lung disease and increased risks during pregnancy are also related to the use of tobacco. As the U.S. Surgeon General has often stated, smoking constitutes the No. 1 preventable cause of death and morbidity in our Nation. I would emphasize the No. 1 preventable cause of death and morbidity in our Nation. As physicians, we counsel our patients who smoke to end their habit in the interests of health; but while most smokers have attempted to quit at some point, physicians see that many fail in their efforts to do so. And that is why we so strongly urge the Government to take action to reduce the consumption of cigarettes by legislating higher cigarette taxes. The benefit of an increase would be enhanced by directing the additional revenues to Federal health programs, specifically the Medicare Program which provides essential health services for the elderly and the disabled of this Nation. This would only be fair as it has been estimated that smoking-related costs to the Medicare Program are currently $5 billion a year. However Congress decides to appropriate the Federal revenue generated by an enhanced cigarette tax, we strongly oppose any allocation of Federal funds for a tobacco price-support system, as has been proposed by the House Ways and Means Committee. We also oppose Federal funds being used to bail out the so-called no-net cost price support program, which has been in place for the past few years and which has generated over 1 billion pounds of surplus tobacco and a potential Federal liability of at least $400 to $500 million. Congress should end price support for tobacco. We are also concerned with smokeless tobacco, Senator Bradley, and its usage; and its growing appeal to young people. At this time, the AMA is reviewing two pieces of legislation for possible support, H.R. 3064 and H.R. 3078. These bills would reestablish a Federal tax on smokeless tobacco products. We have also prepared a draft bill that would require warning labels on smokeless tobacco packages and advertising and ban smokeless tobacco advertising from the electronic media. We would be pleased to provide copies of this draft bill to any of you who may have an interest. Once again, we appreciate this opportunity to express our views, and Mr. Chairman, we commend you and the members of your subcommittee for your involvement and willingness to address this issue affecting the health and well-being of the citizens of this Nation. We must choose between economic issues and health issues. The AMA will stand on the side of health. Thank you.

Senator CHAFEE. Thank you very much, gentlemen.

[The prepared written statement of Dr. Schwarz follows:]

STATEMENT
of the
AMERICAN MEDICAL ASSOCIATION
to the
Subcommittee on Taxation and Debt Management
Committee on Finance
United States Senate

Presented by

M. Roy Schwarz, M.D.

RE: Expiring Cigarette Excise Tax Provisions

September 10, 1985

Mr. Chairman and Members of the Subcommittee:

I am M. Roy Schwarz, M.D., Vice-President for Medical Education and Scientific Policy at the American Medical Association. Accompanying me is Michael Zarski of AMA's Department of Federal Legislation. The AMA appreciates this opportunity to testify regarding our support for increases in the federal cigarette excise tax.

The AMA shares the concern shown by members of Congress regarding the federal excise tax on cigarettes and the fact that on October 1, 1985 it is scheduled to drop to eight cents from the current sixteen cent per pack rate. Congressional concern has been demonstrated by the many members who have introduced or co-sponsored the volume of bills which would repeal the cigarette tax cut. The AMA not only opposes any reduction in the current cigarette tax rate, but has joined with an ad hoc coalition of concerned groups supporting an increase in the federal cigarette excise tax to 32 cents a package. The AMA particularly approves of the approach taken in your bill, S. 874, Mr. Chairman, to increase the tax. As AMA's Executive Vice-President Dr. Sammons stated in his letter to you of July 17th, the AMA intends to support your legislation at every stage of the legislative process.

When Benjamin Franklin wrote that nothing in this world is certain but death and taxes, he spoke of their certainty of existence and their inevitability. He was not referring to the association of one to the other. Certainly he did not envision the opportunity Congress would have to diminish the number of tobacco-related deaths in this nation by raising the cigarette tax. Research strongly suggests, however, that for every 10% increase in cigarette prices, consumption will decrease about 4% among adults and about 14% among teenagers. When Congress raised the cigarette excise tax in 1982, cigarette consumption fell by 5% as a result, according to the Department of Agriculture. Young people and those not yet addicted to tobacco are particularly price-sensitive.

In human terms, reductions in the consumption of tobacco result in fewer instances of smoking-related disease. We know that smoking is the number one cause of lung cancer in the United States, accounting for 90% of all lung cancer deaths. Other cancers, as well as heart and lung disease and increased risks during pregnancy, are also related to the use of tobacco. As the U.S. Surgeon-General has often stated, smoking constitutes the number one preventable cause of death and morbidity in our nation.

We as physicians increasingly have counseled our patients who smoke to end their habit in the interests of better health. However, while most smokers have attempted to quit at one point or another, physicians see that many fail in their efforts to do so. And that is why we so strongly urge the government to take action where it has the ability to reduce the consumption of cigarettes by legislating higher cigarette taxes.

The beneficial impact of an increase in the federal excise tax on cigarettes would be enhanced by directing the additional revenue generated by the tax to federal health programs--specifically the Medicare program which provides essential health care services for the elderly and disabled of this nation and which has been the target of numerous budget cuts in recent years. This would also be fair, as it has been estimated that smoking-related costs to the Medicare program in 1980 alone amounted to $3.8 billion.

However Congress decides to appropriate the federal revenue generated by an enhanced cigarette tax, we strongly oppose any allocation of federal funds for the promotion, growing and marketing of tobacco through a federal price support system as has been proposed by the House Ways and Means Committee (H.R 3128). We oppose federal funds being used to bail-out the so-called "no net cost" price support program which has been in place for the past few years and which has generated over one billion pounds of surplus tobacco and a potential federal liability of at least $400 to $500 million. Congress should end price support for tobacco. To its credit the federal government has recognized the serious health hazards of smoking. The Congress has the ability at this juncture to strengthen and give full credence to the health warnings it imposed on cigarette sales and advertising by removing the federal support for its growth. The dichotomy in the federal message to the public should be removed. Moreover, at a time when every dollar spent by the government is coming under careful scrutiny and dollars are being cut from beneficial health programs, it is wholly inappropriate to divert revenue in order to support the single most preventable public health danger.

Revenue aspects of the cigarette excise tax issue should not obscure the more compelling reason for addressing the issue and for raising the tax to thirty-two cents per pack. The most compelling reason must focus on the adverse health effects of smoking and the over 350,000 of our nation's citizens who died last year of smoking-related disease. Raising the cigarette tax must be aimed at accomplishing health goals. While it is just one of the methods the AMA advocates for meeting the overall goal of a smoke-free society by the year 2000, it is indeed an important, practical and effective measure that is immediately achievable if the Congress squarely faces the issue. Other actions supported by the AMA are listed in the Addendum attached to our statement.

CONCLUSION

Once again, we appreciate this opportunity to express our views and we commend you, Mr. Chairman and members of the Subcommittee, for your involvement and willingness to address directly this issue affecting the health and well-being of the citizens of this nation.

To reiterate the AMA's position, we support an increase in the federal excise tax on cigarettes to 32 cents a pack. We support directing the revenue generated by this increase to Medicare. We strongly oppose diverting this revenue, or any other federal funds, to support the growing of tobacco.

At this time I would be happy to answer any questions you may have.

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ADDENDUM

September 1985

AMERICAN MEDICAL ASSOCIATION
Policy on
Tobacco and Health

For many years the American Medical Association has warned of the relationship between tobacco usage and the incidence of certain diseases. Because of the health hazard involved, the AMA has advocated action that discourages tobacco use. Significant AMA policies and actions are as follows:

- Declare unequivocal opposition to the use of tobacco products;
- Cooperate with public and private agencies to promote a "Smoke-Free Society by the Year 2000";
- Seek elimination of federal price supports for tobacco growing;
- Support legislation requiring rotating health warning labels for cigarette packages;
- Declare snuff and chewing tobacco a health hazard and seek legislation to require warning labels and an electronic media advertising ban for "smokeless tobacco";
- Support legislation requiring labeling of ingredients added to the tobacco in cigarettes;
- Join with other concerned groups in favor of an increase in the cigarette tax to 32¢ per pack;
- Urge newspapers and magazines to refuse voluntarily to accept tobacco product advertisements;

- American Medical Association -
Department of Federal Legislation, Division of Legislative Activities

- Protect the health of youth in the military by opposing the availability of low-cost cigarettes on military bases;
- Seek legislation to prohibit smoking on any public transportation;
- Seek legislation to restrict smoking in public facilities (restaurants, public buildings, etc.);
- Support legislation for developing a "fire-safe" cigarette;
- Seek legislation to prohibit distribution of tobacco product samples by mail;
- Develop state and local model legislation to prohibit distribution of free cigarette samples on public property;
- Urge stricter rules to limit smoking aboard aircraft;
- Urge all hospitals, offices, and other medical care facilities to declare their premises off-limits to smoking;
- Prohibit smoking at all AMA meetings;
- Removed cigarette vending machines from AMA headquarters;
- Develop printed material and public service announcements on the hazards of smoking;

Senator Chafee. Gentlemen, one of the issues that I think is difficult for the Senators to deal with is the testimony presented by the Senators who were here previously. Let's just take the testimony of Senator Ford, where he indicated 110,000 farmers in Kentucky are dependent upon this crop. Although we all can say that if there is a conflict between economics and health, then health should prevail, nonetheless we have seen in a whole series of measures—clean air, clean water, and others—when it comes to a conflict between economics and health, health doesn't always win. I must say that I think the presentation that Senator Ford and the others made was quite touching in that farmers are dependent on tobacco crops. You raise the tax, the consumption goes down. Their ability to support themselves and their families is gone. As I remember his statistics, he said tobacco is grown on about 2 percent of the farms in Kentucky and produces 33 percent of the revenues. That is a startling statistic. Tobacco is grown on 2 percent of the land area and yet produces 33 percent of the revenues.

Now it seems to me, Mr. Neumeyer, that in your statement you said something about the effect on the farmers, that the tax doesn't hurt them. Could you elaborate on that? Or could any of you elaborate a little more because as you know from your experience around here, anything that deals with the family farm starts off with much in its favor. No Senators want to be responsible for doing in the family farm. There is always a widow who says it is the thing between her and poverty. What about that, Mr. Neumeyer?

Mr. Neumeyer. You are right, Senator. I did mention that. There is no question the tax has some impact on farmers. The major problem facing farmers is the import problem, mentioned by Senator Ford and Senator Helms. Senator Helms said 50 percent of tobacco in American cigarettes is imported. We only wish that the excise tax could have that large an effect on driving down the use of tobacco in the United States, but it has not. Imports are the major problem for farmers, but we are certainly sympathetic to their situation. They are having one of their worst years ever, and we have testified in the House in favor of allowing a portion of the cigarette tax to be used to assist them in transitioning to other crops, on that part of the bill introduced by Charlie Rose. So, we are certainly concerned. We would like to help them as much as possible. Senator Ford didn't mention it, but each of the three largest papers in Kentucky have editorialized this year that it is time for Kentucky to get out of tobacco, that it is a road whose end is in sight, and it is time for Kentucky farmers to find other things to grow. I think we all believe that strongly, and we would like to help farmers move into those other areas.

Senator Chafee. I suppose in a small way—and I don't want this analogy to be misconstrued—we have got here something similar to some of the South American countries where marijuana or other drugs are a major cash crop, and a decision has to be made. What do you do? Do you eliminate something that is injurious to health but has tough economic effects? Have any of you others made any studies on these farm statistics, that I thought were very eloquent, as presented by the Senators? Do any of you others have anything on that?

Mr. **Maxwell**. Senator, I would like to make a comment. I was born in Illinois, grew up in Iowa, traveled in Indiana. I have lived in the shade-grown land of Connecticut. I now live in Tennessee, and I know Kentucky well. I have never seen a tobacco field that couldn't grow something else, and it is my opinion, and I think the opinion of my association, that the tobacco farmers' time has come. As my associate here has said, we should be looking to more productive crops that don't decimate the health of the people in this country.

Senator **Chafee**. Senator Bradley.

Senator **Bradley**. Thank you very much, Mr. Chairman. We have talked about the linkage between health costs and the use of tobacco. My question to you is: Can you give us evidence that there is a direct relationship between what the Federal Government has to pay for health care for its citizens and the use of tobacco? Mr. Neumeyer.

Mr. **Neumeyer**. Senator, the statistics I have mentioned were from the National Center on Health Statistics. Perhaps Dr. Kenneth Warner will be better able to answer how those numbers were calculated. I would like to mention, as I did earlier, that the Office of Technology Assessment will soon be giving us a new estimation, including a calculation of how its numbers are arrived at.

Senator **Bradley**. Does anyone else on the panel want to comment?

Dr. **Schwarz**. Senator, as I heard and understood your question, the question was: Are we absolutely certain that smoking carries with it consequential health care costs? I think every study I have seen points out the relationship between smoking and a whole variety of health problems, which from our profession if you treat them, such as cancer, hypertension, coronary artery disease, you have costs. I think to deny that is to deny the reality of the world in which we live. When I hear the relationship between tobacco usage and cost, and the economic side—save the farmer argument—I am always concerned that the total economic impact of the use of tobacco isn't taken into account. Again, the National Center suggested that in 19—I think it was 80—we spent $3.8 billion for Medicare costs, just Medicare; but another $13 billion for non-Federal health care medical care costs. That is to say nothing of an additional $25 billion in lost productivity. Those figures have escalated now up to 1985 and will continue to escalate.

Senator **Bradley**. So, you are saying that the National Center for Health Statistics, and those are the numbers that you used, said that if you combine your first two figures, $14 billion a year is spent on medical care related to smoking-related diseases?

Dr. **Schwarz**. That is correct; $41.8 billion total.

Senator **Bradley**. And you are saying also that about $25 billion resulted from lost earnings, due to morbidity of smoking-related diseases?

Dr. **Schwarz**. Correct.

Senator **Bradley**. And that combination is $40 billion?

Dr. **Schwarz**. Let's throw in Medicare and Medicaid at $3.8 billion. That was in 1980.

Senator **Bradley**. So, it is about $43 billion?

Dr. **Schwarz**. And then you compare that with what you are getting in the excise tax, which is about $5.3 billion.

Senator **Bradley**. All right. If those numbers are even remotely correct, the case is very strongly made. The next question is: How can we be sure that increasing the cigarette tax or keeping it at 16 cents will reduce consumption?

Mr. **Neumeyer**. Senator, aside from the economic predictions that we have made use of in the past, we have two sources from within the Government that have calculated or measured the direct effects of the 1982 increase. The U.S. Department of Agriculture reported in its tobacco outlook and situation report that the 5-percent decline in American cigarette consumption from 1982 to 1983 was primarily caused by the cigarette tax increase. In addition the National Institute on Drug Abuse conducts an annual survey of smoking among high school seniors. This takes place in February and March of every year, and they found that from the class of 1983 when the tax first went into effect in January 1983 to the class of 1984, there was an 8.5-percent decline in smoking by high school seniors. This has followed 2 years of slight increases in smoking among high school seniors. The only thing that happened in that time period to explain the rapid decline was the cigarette tax increase.

Senator **Bradley**. In 1951, the tax on a pack of cigarettes was 37 percent of the price. Today, at 16 cents, it is only 20 percent of the price.

Mr. **Neumeyer**. Right.

Senator **Bradley**. Did cigarette consumption increase from 1951 until 1985?

Mr. **Neumeyer**. Cigarette consumption continued to increase steadily from 1951 to 1964; 1964 was the top per capita rate that we have seen in this century. That, of course, is the time when the first Surgeon General's report came out. It has declined slowly but steadily since then, but of course, every year there are thousands of new children who do take up smoking. Cigarette consumption is still almost 600 billion cigarettes a year.

Senator **Bradley**. What is that again?

Mr. **Neumeyer**. 600 billion cigarettes a year.

Senator **Bradley**. And your point is that the tax on cigarettes should at least be where it was in 1951 as a percent of the price?

Mr. **Neumeyer**. Yes, and on a real basis adjusted for inflation, that is how we arrived at the 32-cent level.

Senator **Bradley**. Thank you. Mr. Chairman, I might just say that I am sure we are going to hear a lot about imports. It is a little bit like a few years ago when we had gasohol. And any time somebody wanted to get something passed, they said gasohol, and it passed through the Congress that year. This is the year where, I am afraid, that any time somebody says "import sensitive," they believe that that is the way they are going to get their legislation passed. But I would like to just draw a distinction between cigarettes, the health costs involved in cigarettes, and the basic equity question: What should a tax be on a pack of cigarettes today relative to where it was in 1951? And keep the import question separate. The issue in imports is the price of an import, which is directly related to the value of the dollar. If you had the value of the dollar drop 5 percent or 10 percent, that would offset the increase in the cigarette tax. So, I think that the import argument is somewhat bogus in real terms.

Senator **Chafee**. I agree with you, Senator. I did not completely understand the import argument. I asked Senator Ford—maybe you weren't here—and I failed to be absolutely clear about his response. But we have got the tobacco growers coming up next and the representatives of the industry, so we will talk with them. Just a quick question, sort of a trivia question, if you would: Dr. Schwarz, what is a fire-safe cigarette?

Dr. **Schwarz**. I'm sorry?

Senator **Chafee**. What is a fire-safe cigarette?

Dr. **Schwarz**. One that doesn't create fire when it is discarded while lit.

Senator **Chafee**. It must be awfully difficult to smoke a fire-safe cigarette.

Dr. **Schwarz**. No; there is no difference when it is smoked, but it doesn't burn upholstery and flammable materials like that.

Senator **Bradley**. It is not made by international flavors and fragrances.

Dr. **Schwarz**. When it is not smoked, sir, it is self-extinguishing. It doesn't burn on its own.

Senator **Chafee**. You mean you have to draw on it?

Dr. **Schwarz**. Yes you have to pull oxygen into it.

Senator **Chafee**. All right. Now, did you get a clear answer, Senator Bradley, on your statistics, or are we going to get those from Dr. Warner? Again, what is the cost to health in the United States?

Senator **Bradley**. Yes; I got clear on that.

Senator **Chafee**. What is the figure?

Senator **Bradley**. $40 billion. $14 billion in direct health care costs, and $25 billion from lost earnings due to morbidity or cigarette-related diseases.

Senator **Chafee**. Thank you very much, gentlemen, for coming. The next panel is Mr. Horace Kornegay, Mr. W.L. Carter, Mr. Richard Estey, and Mr. Terry Burns. All right, gentlemen, if we can move right along. We have eight witnesses in the next hour. Mr. Pendergast, we welcome you here.

Mr. **Pendergast**. Thank you, Mr. Chairman.

Senator **Chafee**. You are a backup witness?

Mr. **Pendergast**. I am, yes.

Senator **Chafee**. Mr. Pendergast is a magnificent reservoir of information. All right, Mr. Kornegay, why don't you proceed? If you would limit your testimony to the 5 minutes, we would appreciate it.

STATEMENT OF HORACE R. KORNEGAY, CHAIRMAN OF THE BOARD, TOBACCO INSTITUTE, WASHINGTON, DC

Mr. **Kornegay**. Yes, sir. Mr. Chairman, I am Horace R. Kornegay, chairman of the Tobacco Institute, which is a trade association of 12 companies that manufacture tobacco products. At the outset, I am going to very quickly summarize my more lengthy statement, Mr. Chairman, but I would request that my entire statement be placed in the record.

Senator **Chafee**. Yes; that will be done.

Mr. **Kornegay**. Mr. Chairman, we come here today to ask you to leave unchanged the decision made by the Congress in 1982 and reaffirmed by your committee, the Finance Committee, last year to permit the temporary tax increase on cigarettes to expire at the end of the current fiscal year. Now, time permits me only to skim over a few of the points that are contained in our lengthy statement. Any legislation to set the Federal excise tax rate on cigarettes above 8 cents is legislation to raise taxes. This is the position taken by this administration before the House Ways and Means Committee in June in expressing its opposition to proposals of this kind. The distinguished majority leader of the Senate took the same position when he said, and I quote: "The law says the tax will go to 8 cents this fall. If we change the law, we raise taxes, pure and simple." Now, the Congress is currently seeking to make our tax system fairer, more neutral in its impact, more conducive to economic growth, and less burdensome on lower income groups. If we were to decide to increase the excise tax on cigarettes, you would be violating each of these generally supported objectives of tax reform. You would be unfairly penalizing one industry and the consumers of its products. You would be reducing jobs and other economic benefits that the tobacco industry would provide if taxed on the same basis as other industries. You would be imposing the most regressive tax on those least able to pay. The cigarette excise tax is collected in a disproportionate share from the poor and lower and middle income classes. About 40 percent of the revenue it yields is collected from those with incomes under $20,000 a year. I know of no other industry that bears a tax burden comparable to that borne by the tobacco industry, and in the final analysis, largely by its consumers. When all types of taxes imposed on cigarettes by all levels of government are added up, 48 cents out of every dollar goes for taxes, an effective tax rate of more than 92 percent. This, I submit, is excessive. The burden should be lightened, Mr. Chairman, not increased. A great part of this burden is the result of State taxation. In the past three decades, State taxes on cigarettes have increased by 440 percent, yielding a tenfold increase in revenues from that source. For the Congress now to reverse its decision on permitting the Federal excise tax to sunset, the effect would be disruptive on State finances. The 17 States which have provided for higher State taxes on cigarettes contingent on the sunset would justifiably complain that they have been victimized by the change of Federal policy. Now, let me call the subcommittee's attention particularly to the plight of the tobacco farmer, a plight graphically demonstrated by a decline of one-third in the number of such farms in South Carolina and Georgia, and a decline of one-fifth or more of such farms in the States of North Carolina, Maryland, and Virginia. A victim of reduced sales caused principally by higher taxes and an overvalued dollar, the tobacco farmer is hurting, Mr. Chairman. A Federal tax rate of 16 cents or more on cigarettes obviously doesn't help the farmer. Some have proposed not only increasing the Federal tax on cigarettes but also earmarking the revenue for various spending programs. The Tobacco Institute and its members strongly oppose all forms of this kind of unsound fiscal policy as a way of masking higher spending and as an intrusive device to control personal behavior. The tobacco industry provides directly and indirectly more than 2 million jobs and accounts for more than $80 billion of the gross national product. Now, I ask this subcommittee to pursue a tax policy that will not impair this contribution to the Nation's economy and will not add to the excessive unfair and regressive tax borne by the 55 million consumers of tobacco products. Thank you very much, Mr. Chairman.

Senator CHAFEE. Thank you very much, Mr. Kornegay. Mr. Carter?

[The prepared written statement of Mr. Kornegay follows:]

STATEMENT OF HORACE R. KORNEGAY, CHAIRMAN, THE TOBACCO INSTITUTE

I am Horace R. Kornegay, Chairman of Tobacco Institute, the trade organization of 12 companies which manufacture tobacco products. I appreciate this opportunity to testify before your subcommittee of the Senate Finance Committee.

Mr. Chairman, in 1982 the Congress enacted a temporary doubling of the Federal excise tax on cigarettes and provided that this addition to the basic tax would sunset on September 30, 1985. Last year, you will recall, the Senate Finance Committee reaffirmed the expiration of the additional tax by a vote of 11 to 5. You are today considering whether to permit this decision to remain unchanged.

It should be made clear at the outset that any legislation to set a rate above 8 cents a pack is a tax increase. That was the position taken by the Treasury Department testifying on behalf of the Administration before the House Ways and Means Committee in June.

In addition, the distinguished majority leader of the United States Senate recently and succinctly said,

> The law says the tax will go to eight cents this fall. If we change the law we raise taxes, pure and simple.

Mr. Chairman, much is being heard about tax reform these days. Among the guiding objectives of tax reform on which there seems to be general agreement are the following:

- -- reform should provide a fairer and more neutral system equalizing burdens and eliminating loopholes
- -- reform should favor economic growth and reduce obstacles to growth
- -- reform should relieve the burden on those in the most depressed economic groups.

Raising the cigarette excise tax would violate each of these principles.

At a time when Congress should be seeking to make the tax system more fair, it would be strangely inconsistent to increase the tax burden borne by the one-third of the adult population who choose to smoke. At a time when Congress should be seeking to make the tax system more neutral, it would be patently unfair to raise a tax that singles out the consumers of one industry.

Ata time when Congress should be seeking to promote economic growth, it would be "anti-growth" to use the taxing power to raise costs, reduce sales and eliminate the jobs and other economic benefits our industry would provide if it were taxed on the same basis as other industries.

At a time when the President and the Congress are seeking to make the tax system less burdensome on the poor, it would be unfair to double the scheduled rate of a regressive tax that bears most heavily on those least able to pay.

The issue of regressivity deserves particular attention. One authority, Robert Tollison, professor of economics at George Mason University, has testified that "Excise taxes on tobacco products are the most regressive of the selective consumption taxes..."

The burden of the cigarette excise tax on those with an annual income below $10,000 is ten times as great as that borne by those with income between $50,000 and $100,000. The regressive effect of this tax is intensified because smoking is more prevalent among lower income groups than among those in higher income brackets. This is a tax which is collected in disproportionate share from the poor and lower middle income classes.

A study by deSeve Economics Associates, commissioned by the Tobacco Institute, only recently completed but not yet published, confirms this. This study shows that 39 per cent of the cigarette excise taxes - close to $4 billion - is paid by people earning under $20,000 a year, while only about 2 per cent - approximately $200 million - is paid by those earning over $100,000 a year. We request your permission to provide the study when it is published for inclusion in the hearing record.

Regressiveness is by no means the only defect of the form of taxation you are considering today.

The selective excise tax has been subjected to strong criticism by economists. No less an authority than the Assistant Secretary of the Treasury for Tax Policy, Ronald A. Pearlman said last December:

> ...you will not find any economist and you will not find me defending excise taxes as anything other than revenue raisers. They are regressive. They are industry specific. They are unsound in my judgment from any economic or tax policy basis...I would not seek to defend them on any rational basis.

In view of all of these manifold defects, we urge that this form of taxation be used sparingly and its rates kept low.

The Federal cigarette excise tax should not be considered in isolation from the many other forms of taxation imposed by government at all levels on the producers and users of tobacco. The tax burden borne by this industry and its customers is mammoth in comparison with that borne by business in general and by consumers of other products.

The magnitude of this burden is established in a forthcoming study by Chase Econometrics. It finds that, when all types of taxes paid to all levels of government are taken into consideration, 48 per cent of the expenditure of smokers for tobacco products ends up in the hands of Federal, state and local tax collectors.

Two factors explain this extraordinarily high figure. First, the tobacco industry and its customers are singled out for an added charge in the form of excise taxes, yielding close to $10 billion annually to the treasuries of the Federal Government, all 50 states and approximately 400 local governments. Secondly, cigarette manufacturers bear one of the heaviest effective rates of Federal corporate income taxation.

In considering whether to increase the scheduled cigarette excise tax after October 1 of this year, Mr. Chairman, your Subcommittee should make its decision mindful of the entire excessive tax burden now imposed on those who choose to smoke.

Obviously, the states, which rely heavily on tobacco taxes, are greatly affected by any decisions you make on the Federal tax. There is a widespread attitude among state officials that a higher Federal tax poaches on a field which should belong to them. Three years ago the President, under the concept of the New Federalism, gave support to this position by proposing that the Federal Government withdraw from this field of excise taxes leaving it exclusively to the states.

Between 1951 and 1982 the Congress respected the primacy of the states in this field of taxation. The Federal excise tax remained at 8 cents while the states raised cigarette taxes frequently and substantially. In three decades state revenues from this source rose from $465 million annually to more than $4 billion - almost a ten-fold increase. During this period, states increased the tax rate on cigarettes by 440 per cent.

Seventeen states, anticipating that the temporary added excise tax on cigarettes would sunset on schedule, have this year provided for an increase in their cigarette taxes.

Were the Congress to reverse its decision on the Federal tax, the effect would be disruptive on State finances, and those States which have taken such action contingent on the sunset can justifiably complain that they have been victimized by a change of Federal policy.

Mr. Chairman, let me invite the attention of your Subcommittee to one other important consideration that should enter into your decision on the Federal cigarette excise tax -- the plight of the tobacco farmer.

The Federal tax increase was imposed at a time when the problems of the tobacco farmer were mounting. Between 1978 and 1982 chronic adversity in this sector of agriculture was manifested by a steep reduction in the number of farms producing tobacco in several states. During these years the number of tobacco farms in North Carolina decreased by 26 per cent; in South Carolina, by 33 per cent; in Georgia, by 31 per cent; in Maryland, by 21 per cent; and in Virginia, by 18 per cent. Then, in 1983, the year the Federal tax increase became effective, the tobacco farmer suffered a decline of one-third in the cash value of his crop.

Currently, the unsold stocks of tobacco under Commodity Credit Corporation loan -- tobacco that was not bought in the market at the support price -- amounts to more than 1-1/4 billion pounds. The tobacco grower is hurting.

I trust that the Congress, in its concern to help the agricultural community in general, will not ignore the tobacco farmer. And I hope this Subcommittee will ask whether a 16-cent Federal tax on cigarettes helps the farmer.

Mr. Chairman, while not specifically invited to speak to this point, I am constrained to mention one other tax proposal of grave concern to the cigarette industry.

Legislation has been introduced which would not only increase the Federal excise tax on cigarettes but would also earmark a part of the revenue from this tax for specific spending programs. The most common form of earmarking proposed would direct the revenue to the Hospital Insurance Trust Fund, but there are also proposals to apply the funds to the tobacco price support program and to subsidize a transition of tobacco farmers into other occupations.

All of these proposals would introduce an undesirable rigidity into the fiscal structure of government, binding the hands of Congress in the future determination of how revenues should be allocated, weakening Congressional control over spending programs, and making budgetary adjustments more difficult. As recent experience demonstrates, the last thing the Congress needs is another obstacle to control of the budget.

Earmarking of any part of the revenue from the cigarette excise tax for the Hospital Insurance Trust Fund cannot be justified. The Fund is healthy, and its condition is improving. There is no credible evidence that smokers impose a disproportionate burden on this, or on other government health programs. Nor is there evidence that the nation's smokers, who support such programs by their payroll and income taxes, are undertaxed for the services they receive. And, finally, if the Congress wishes to try to measure health risks in terms of their effect on health care costs, consistency would dictate that a long list of products -- not just one -- be considered as candidates for taxes earmarked for health programs.

The Tobacco Institute strongly opposes any and all proposals to earmark the cigarette excise tax for any purpose.

In 1983 some 710,000 jobs were involved in producing and distributing tobacco products, and an additional 1.6 million jobs depended on the spending of workers in the tobacco industry. Tobacco accounted directly for $31.5 billion of the Gross National Product and indirectly for an additional $50.6 billion. One of the few bright spots in the U.S. 1984 balance of payments was the more than $2 billion surplus of tobacco exports over imports.

Thus, when I ask this Committee to let the temporary added tax on cigarettes expire on schedule, I make this request on behalf of an industry important to the nation's economy. Tobacco farmers, distributors, thousands of retail establishments, the manufacturers and sellers of tobacco products, and 55 million consumers will be affected by your decision.

STATEMENT OF W.L. CARTER, JR., PRESIDENT, TOBACCO GROWERS ASSOCIATION OF NORTH CAROLINA, INC., SCOTLAND NECK, NC

Mr. CARTER. I will summarize as well. I am W.L. Carter, Jr., a tobacco farmer from Scotland Neck, NC. I am here today as President of the Tobacco Growers Association of North Carolina, an organization that speaks for about 3,000 tobacco farmers in our State. Tobacco is important in our State. We grow two-thirds of all Flue-cured tobacco and 43 percent of all tobacco grown in the United States.

It accounts for over $1 billion a year in farm income. Just so you understand how big it really is, that is larger than income from the Kansas wheat crop or the Texas cotton crop or Arkansas broilers, or Florda oranges or California grapes or Idaho potatoes. And each of those States is the leading producer of that commodity in the United States. So, you can see why we are concerned over anything that threatens our tobacco. Our board of directors in a meeting on June 19, 1985 went on record as supporting the sunset provision that was included in the bill passed by Congress in 1982 when the Federal excise tax was increased from 8 to 16 cents.

I am here today to remind your committee that the general public as well as tobacco farmers were told that the additional 8 cents would be in effect only until September 30, 1985. We are asking Congress to honor that commitment. We tobacco farmers accepted that tax increase in 1982 as it was portrayed, as a temporary measure that appeared to be in the best financial interest of the Nation as a whole at that time. We gave up our opposition even though we knew it would severely penalize us and our customers. Looking back, however, I am not sure we understood just how severe the penalty would be on the tobacco farmer. As you know, cigarette sales dropped almost 6 percent after the tax was doubled.

Gentlemen, when cigarette sales go down, for whatever reason, manufacturers need less tobacco. We farmers knew that, but we hadn't understood how quick and how severe it would affect us as growers. We now understand that, since the manufacturer has a 2- to 3-year supply of tobacco on hand and aging all the time, a sudden drop in future sales projection has a double or triple impact on the amount of tobacco they need to buy off the current market. If sales are expected to be down 6 percent for the next 3 years, they have from 12 to 18 percent more tobacco already on hand than they are going to need. The only way to adjust for that is to reduce purchases for the next 3 years.

We saw that happen on our markets in 1982, 1983, and 1984. And because our domestic cigarette manufacturers needed to buy less tobacco, our stabilization cooperative receipts increased dramatically for each of those 3 years. In fact, our inventories are now at an almost all-time high, and the interest charge we are having to pay the Commodity Credit Corporation on those stocks threatens to bankrupt our program. In some ways tobacco farmers feel Congress almost delivered a one-two knockout punch in 1982 when they passed the no-net cost tobacco bill and then doubled the excise tax. Our tobacco quota has been cut over 25 percent since 1982. Because of the lower volume, our farmers are less efficient today. The profit margins are smaller. Because the requirements of the no-net cost tobacco bill this year, tobacco farmers will pay in assessments over $500 on every acre of tobacco they grow to finance their program.

I am growing 55 acres this year, and that means that I will contribute $37,500. I am not aware of any other farm commodity that is forced to shoulder such a financial burden. Tobacco farmers are taxpayers, too, but we feel we have been singled out unfairly by overtaxing our product and denying us the same financial assistance provided producers of other commodities. We recognize there are other factors contributing to the exploding increases we have seen in our assessments. But I honestly believe that the doubling of the excise tax is the most single important one. We are aware that there are a number of bills that have been introduced to double the tax and to raise it from 16 cents to 32 cents.

We plead with you not to let that happen. The impact on farmers I described for you resulting from the doubling of this tax in 1982 would be more than twice as severe if we doubled it again. It would, in fact, be devastating to the tobacco farmers. Our association believes tobacco farmers have done more than their share in helping solve the financial problems of our Nation. It has taken its toll, though. There are thousands of tobacco farmers who, because of the quota cuts and the increasing assessments, have been forced to leave the farm and seek other employment. It is not a good time to be looking for off-farm employment. For many, their only alternative will be some form of public assistance. Many are just hanging on, hoping for a better year next year. Included in that group are some of our better farmers.

We need some relief, and you can give it to us by allowing the additional 8 cents excise tax to expire as promised on September 30, 1985. I would like to add a personal point also. I am a smoker also—about a pack a day. So, I have experienced the economic impact of this tax as a consumer. I figured it has cost me close to $100 since you doubled the tax, and I keep trying to figure out what extra services I have received for those taxes I paid that the nonsmoker didn't receive. So, speaking as a consumer, I think I have also done my share. It is time I got a little relief, too. Thank you for allowing me to express both my views and the views of my association.

Senator **Chafee**. Thank you very much, Mr. Carter. Mr. Estey.

[The prepared written statement of Mr. Carter follows:]

Statement of W. L. Carter, Jr., President
The Tobacco Growers Association of N.C., Inc.
Presented to
The Subcommittee on Taxation and Debt Management
of the United States Senate Committee on Finance

I am W.L. Carter, Jr., a tobacco farmer from Scotland Neck, North Carolina. I am here today as President of the Tobacco Growers Association of North Carolina, an organization that speaks for about 3,000 tobacco farmers in our State.

Tobacco is important in our state. It's grown in 90 of the 100 counties. We grow two-thirds of all the flue-cured tobacco and 43% of all the tobacco grown in the U.S. It accounts for over $1 billion a year in farm income - over one-fourth of our total farm sales. Just so you understand how big it really is, that's larger than the income from the Kansas wheat crop, or the Texas cotton crop, or Arkansas broilers, or Florida oranges, or California grapes, or Idaho potatoes. And each of those states is the leading producer of that commodity in the U.S. So, you can see why we're concerned over anything that threatens our tobacco.

Our board of directors, in a meeting on June 19, 1985, want on record as supporting the sunset provision that was included in the bill passed by Congress in 1982 when the federal cigarette excise tax was increased from 8 cents to 16 cents. I am here today to remind your Committee that the general public as well as tobacco farmers were told that the additional 8 cents would be in effect only until September 30, 1985. We're asking Congress to honor that commitment.

We tobacco farmers accepted that tax increase in 1982 as it was portrayed--as a temporary measure that appeared to be in the best financial interest of the Nation as a whole at that time. We gave up our opposition even though we knew it would severely penalize us and our customers. We were willing to shoulder our share of a burden we all faced. Looking back, however, I am not sure we understood just how severe the penalty would be on the tobacco farmer.

As you know, cigarette sales dropped almost 6 percent after the tax as doubled. Gentlemen, when cigarette sales go down, for whatever reason, manufacturers need less tobacco.

We farmer knew that, but we hadn't understood how quick and how severe it would affect us as growers. We now understand that since the manufacturer has a two or three years' supply of tobacco on hand and aging all the time, a sudden drop in future sales projections had a double or triple impact on the amount of tobacco they need to buy off the current market.

If sales are expected to be down 6 percent for the next three years, they have from 12 percent to 18 percent more tobacco already on hand than they are going to need, and the only way to adjust for that is to reduce purchases for the next three years.

We saw that happen on our markets in 1982, 1983, and 1984. And because our domestic cigarette manufacturers needed to buy less tobacco, our Stabilization Cooperative receipts increased dramatically for each of these three years. In fact, our inventories are now at an almost all-time high and the interest charges we are having to pay the Commodity Credit Corporation on those stocks threatens to bankrupt our program.

In some ways, tobacco farmers feel Congress almost delivered a one-two knockout punch in 1982 when they passed the No-Net-Cost Tobacco Bill and then doubled the excise tax. It has been downhill ever since. Our tobacco quota has been cut over 25 percent since 1982. Because of the lower volume, most farmers are less efficient today and their profit margins are smaller. Because of the requirements of the No-Net-Cost Tobacco Bill this year tobacco farmers will pay in assessments over $500 on every acre of tobacco they grow to finance their program. I am growing 55 acres this year, and so that means I will contribute $37,500. I'm not aware of any other farm commodity that is forced to shoulder such a financial burden. Tobacco farmers are taxpayers, too, but we feel we have been singled out unfairly by over taxing our product and denying us the same financial assistance provided the producers of other commodities.

We recognize there are other factors contributing to the exploding increases we have seen in our assessments, but honestly believe the doubling of the excise tax is the single most important one.

We are aware that there are a number of bills that have been introduced to double the tax and raise it from 16 cents to 32 cents. We plead with you to not let that happen. The impact on farmers I described for you resulting from the doubling of this tax in 1982 would be more than twice as severe if we double it again. It would, in fact, be devastating to tobacco farmers.

In summary, our Association believes tobacco farmers have done more than their share in helping solve the financial problems of our Nation. It has taken its toll, though.

There are thousands of tobacco farmers who, because of the quota cuts and the increasing assessments, have been forced to leave the farm and seek other employment. It's not a good time to be looking for off-farm employment. For many, their only alternative will be some form of public assistance. Many are just hanging on, hoping for a better year next year. Included in that group are some of our better farmers. The financial pressures are simply too great.

We need some relief and you can give it to us by allowing the additional 8 cents excise tax to expire ,as promised, on September 30, 1985.

May I add a personal point?

I am also a smoker--about a pack a day--and so I have experienced the economic impact of this tax as a consumer. I figure it has cost me close to $100 since you doubled the tax, and I keep trying to figure out what extra services I have received from those taxes I paid that the nonsmoker didn't receive.

So, speaking as a consumer, I think I have also done my share and it is time I got a little relief, too.

Thank you for allowing me to express both my views and those of the tobacco farmers our Association represents.

STATEMENT OF RICHARD C. ESTEY, VICE PRESIDENT, CANTEEN CO. OF OREGON, PORTLAND, OR

Mr. ESTEY. Yes. My name is Richard Craig Estey. I am a tobacco distributor, or cigarette distributor, and a vending machine operator from Portland, OR. The first point that I would like to bring up, and I have two main points to bring up. The first one is my agreement with Senators Symms and Durenberger regarding letting the States be able to handle the additional excise tax if they were to have one. In my home State, the State of Oregon, our local State legislature has already passed a replacement 8-cent tax. It ends up taking place on the anticipation of the sunsetting of the Federal excise tax that is going to take place regardless whether the Federal tax sunsets or not, which then adds an undue financial burden. But the real issue that I want to bring up, and nobody this morning has really brought it up—and I know I am speaking adversarial to both of you Senators—but most people think of the tobacco industry as being a very large industry. It is dominated by five or six main manufacturers, a couple of smaller manufacturers, and fed by some growers, brokers in the tobacco business, but I am from the distribution side of the industry, which is dominated. There are 3,500 distributors across the United States and literally hundreds of thousands of retailers of cigarettes. Most of these businesses are small, independent, family operated businesses, and tobacco products can represent 20 to 30 percent of the total sales of their different businesses. In the distribution side, this is a hard concept to grasp. There are two different areas that distribution primarily goes through. One is a value-added distribution system where, all of a sudden, a retailer or distributor adds a value to the goods or services that he provides to the public. The other one is a very mass-merchandiser type of distribution system that competes solely on price. And coming from the small retailer side, what is happening as a result of the excess taxation, the external forces that are being put on tobacco retailers and tobacco wholesalers is that all of a sudden it is skewing the competitive advantage toward the retailers that can compete primarily on price. I will throw out some numbers to you. The overall consumption of tobacco or of cigarettes—the numbers that are being thrown out—of being down 4 percent this year. That 4 percent doesn't happen across the whole industry spectrum, across every retailer of the product. I am in the vending industry. My sales in vending machines over the last 10 years, and I am only in the State of Oregon, so we have different taxes. But my sales in vending machines have dropped 40 percent in sales. So, all of a sudden, it is becoming such an economic issue to your constituents and the constituents of the other Senators that all of a sudden their livelihoods are steadily being eroded away in a disproportionate amount compared to, all of a sudden, in a mass-merchandiser type of retailing. They don't have very high labor costs. So, all of a sudden, you don't see them—what do you want to say?—fighting against an increase in the excise tax because to a lot of retailers—my business went down 40 percent. There is a whole other group of retailers who went up, and those retailers are primarily large, big business, the large regional chains, and not the small independent convenience store, vending machine operator, restaurants, or anything like that. That is all I have. I thank you very much for your time.

Senator **Chafee**. Thank you very much, Mr. Estey, for your testimony. We appreciate your coming this long distance.

Mr. **Estey**. Thank you.

Senator **Chafee**. Mr. Giso.

Mr. **Burns**. Mr. Chairman, Mr. Giso could not be here because of a personal matter. If it is appropriate with the Chair, I would like to read his testimony, if I could.

Senator **Chafee**. Your name is?

Mr. **Burns**. My name is Terry Burns. I am executive director of the National Association of Tobacco Distributors, of which Mr. Giso is a member.

Senator **Chafee**. I see. Why don't you proceed?

Mr. **Burns**. Thank you, Mr. Chairman.

[The prepared written statement of Mr. Estey and a letter to the Canteen Co. of Oregon from John Rich follow:]

TESTIMONY OF
RICHARD CRAIG ESTEY
CANTEEN COMPANY OF OREGON, PORTLAND, OREGON
TO
SENATE FINANCE COMMITTEE'S SUBCOMMITTEE
ON
CIGARETTE EXCISE TAX
SEPTEMBER 10, 1985

I appreciate the opportunity to address this Senate Finance Committee's Subcommittee on the topic of the cigarette excise tax.

I would first like to address the $.08 impact this tax would have on the State of Oregon and Washington.

In following the President's strategy of having state and local government take on more responsibility, the State of Oregon has already placed a tax of $.08 per pack to replace the sunsetting federal $.08 tax. This tax will go into effect regardless of what happens to the federal tax, thereby already increasing tobacco product's taxation.

The State of Washington did not replace the federal tax with one of their own. In effect, reducing taxes for its citizens in a non-progressive manner.

But, my real concern lies with the lack of economic stability and prosperity for the small busineses caused by failure to allow sunset of the cigarette excise tax or imposition of another cigarette tax.

Stereotypically, we think of the tobacco industry as a "big" business. However, in actualality, the industry is dominated by six manufacturers and the "bigness" stops there. We forget that these manufacturers are supplied through farmers, brokers, support services across the United States and that the tobacco products are remarketed through 3,500 small disbributors and literally hundreds of thousands of retailers (convenience stores, gas stations, grocery stores, vendors, restaurants, etc.), most of which are small family-operated businesses.

In our already price conscious society, failure to allow sunset of the cigarette excise tax or imposition of another cigarette tax would have a disastrous impact on these small businesses. The disproportionate heavy taxes make tobacco products extremely price sensitive in relation to value, thereby forcing the consumer to shop for price.

The only retailers positioned to compete solely on price are the large regional and national chains. These retailers buy in large enough volumes to allow by-passing traditional distribution and purchase direct from manufacturers, enabling them to sell for prices that cannot be matched by small business.

Addressing the vending market specifically, in the past years, the number of cigarette machines have dropped 17.2% and we have seen a drastic drop in the unit volume of pack sales. Twenty percent of all vending sales are tobacco products and this percentage increases in other retail operations such as convenience stores. Tobacco products are a very substantial sales product category and are a vital part of business to small retailers in terms of sales and profitability and economic stability.

Please don't misunderstand, "small" business is willing to compete with "big" business and their predatory pricing with our added value retailing - convenience, location and hours, personal attention, all coupled with fair pricing.

However, the tobacco industry's being the target of several external forces such as this excess cigarette taxation, on a product category that more than pays its share, skews the competitive advantage towards big business and it becomes unfair. Our 'added values' to promote and increase our business becomes insignificant compared to price.

Further, consider the fact that tobacco products are the most regressive of the selective consumption taxes and is already a tax which is collected in disproportionate share from the lower middle income classes rather than "big" business and is a tax which is definitely industry specific. The tax responsibility sustained by the tobacco industry and its consumers is immense in relation to that of other industries in general and by consumers of other products.

In closing, I ask this Senate Finance Committee's Subcommittee let the temporary added tax on cigarettes expire as scheduled and not be replaced in order to provide economic stability to those most affected by this tax, the small businesses comprised of farmers, distributors and retail operations all across the United States.

Rich and Rhine, Inc.
WHOLESALER DISTRIBUTORS
140 S.E. 28TH AVENUE
PORTLAND, OR 97214
PHONE 503 233-4631

August 23, 1985

Canteen Company of Oregon
501 North Lagoon Avenue
Portland, Oregon 97217

Attn: Craig Estey

Dear Craig,

It is my understanding that you will be testifying in September before a Senate committee hearing on the federal cigarette tax. Please convey to the Committee that the addition of a federal tax will have a disastrous effect on the wholesaling and retailing of tobacco and candy in the state of Oregon. Many small retailers will no longer be economically viable operations. This includes the small "mom - pop" stores as well as the Oregon Commission of the Blind supervised smoke stands.

Oregon has already replaced the sunseted 80¢ a carton federal tax with one of its own. Let Congress keep its promise and allow this tax to lapse.

Very truly yours,

John Rich

John Rich
RICH & RHINE, INC.

JR/dw

STATEMENT OF JACKIE GISO, PRESIDENT, JACKIE GISO, INC., CRANSTON, RI, AS PRESENTED BY TERRY J. BURNS, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS, ALEXANDRIA, VA

Mr. Burns. The National Association of Tobacco Distributors [NATD], which represents over 570 small business wholesale distributor members, with over 740 distribution outlets. Our association also represents 230 manufacturer and supplier associate members whose 12,000 salesmen canvas and supply almost 1.5 million retail outlets selling tobacco products across the United States. Our industry markets goods with an estimated annual wholesale value of over $16 billion. We appreciate the opportunity to present NATD's position on whether the current level of Federal cigarette excise tax should be extended beyond the September 30, 1985, deadline.

The NATD urges this committee to comply with the intent of Public Law 97-248, the Tax Equity and Fiscal Responsibility Act of 1982, which contains a sunset provision that would reduce the tax rate from 16 cents to 8 cents per pack on October 1, 1985. In addition, we believe that this committee should also adopt a floor stocks tax rebate provision, similar to the one considered for inclusion in last year's Deficit Reduction Act of 1984. That is Public Law 98-369. That would provide for refunds of 8 cents for every pack held in inventory on October 1, 1985. I would like to emphasize some of our policy considerations regarding the sunset provision and rebates. In 1983, TEFRA cigarette tax increase placed a significant burden on the wholesaler because it included a floor stocks tax. According to the Treasury Department, the one-time tobacco floor stock tax on inventory held on January 1, 1983, produced $180 million in revenue, all of which was paid by the tobacco wholesale industry. With the scheduled lowering of the Federal cigarette excise tax, the opposite should occur. There should be a rebate of the taxes which have already been paid on inventory held on October 1, 1985. Legislative language should be included in the House and Senate tax bills as was included by the House Ways and Means Committee last year to include a floor stocks tax rebate for such inventory. At this time, Mr. Chairman, I would like to include in my testimony a copy of the letter which was sent by Steve Bloom, chairman of our association legislative committee and a member of the executive committee, to the chairman of the House Ways and Means Committee, Congressman Dan Rostenkowski, outlining the floor stocks tax rebate language we support. We would urge you to include this language in the Senate legislation prior to the end of this month.

[The prepared letter of Mr. Bloom, legislative chairman, Illinois Association of Tobacco and Candy Distributors, follow:]

ORGANIZED 1951

ILLINOIS ASSOCIATION OF TOBACCO & CANDY DISTRIBUTORS

area code 217 telephone 544-7161

Cigarettes Don't Pay Taxes
PEOPLE DO!

July 12, 1985

The Honorable Daniel D. Rostenkowski
Chairman
Committee on Ways and Means
U. S. House of Representatives
2111 Rayburn House/Office Building
Washington, D. C. 10515

Dear Mr. Chairman:

There is a key tax issue of concern to the tobacco wholesale distributors, relating to floor stocks taxes, if this year's tax bill reduces the cigarette excise tax by allowing the "sunset" to take effect. Enclosed are five attachments which we prepared last year in our lobbying the House and Senate Tax Committee on this issue:

(1) This is a copy of the present law containing the original floor stocks provision, for which the tobacco wholesalers paid a one-time tax totaling over $180 million, according to the Department of the Treasury;

(2) During Congressional consideration of the Tax Reform Act of 1984, the NATD sought to have the enclosed "Version I" tax rebate on floor stocks of cigarettes inserted in the language of the bill. As you know the House bill proposed to lower the tax from 16 cents to 12 cents per pack. "Version I" language is similar to that contained in TEFRA of 1982 and is the language that should be inserted if any "sunset" provision is included in a 1985 tax bill;

(3) The third document is the cigarette floor stocks language which actually was inserted in the Conference Report on H. R. 4170 (Public Law 98-369);

(4) "Version 2" was the NATD's lobbying effort to revise the Conference Report, floor stocks rebates language to bring this section into the realities of the wholesale-distribution-industry business operations;

(5) The June 29, 1984 (Page H 7529) Congressional Record includes a staff initiated amendment in the Technical Corrections Bill (H. Con. Res. 328) to H.R. 4170, the Tax Reform Act, which deleted the floor stocks rebate provisions in the third document we submitted to you.

We would greatly appreciate your assistance in inserting a floor stocks tax rebate section ("Version 1") in this year's tax bill should the present 16 cents tax be reduced. Finally, should a cigarette excise tax be increased above 16 cents per pack in this year's tax bill, it will be necessary to insert a provision in the language of the bill extending the filing and payment date of one-time floor stock tax returns to at least the same as it was in 1982. This 1982 extension of time to pay such a tax was inserted in a Technical Corrections Act of 1982.

Please let me know if we can assist you in pursuing these matters.

Very truly yours,

Stephen Bloom

Stephen J. Bloom
Legislative Chairman

SJB/ki
Enclosure

cc: Illinois Legislative Committee
    Dale E. Burklund
    Jack E. Funderburg
    Dan J. McLaughlin
    G. Edward Meyer
    Wayne W. Weeke

Mr. BURNS. It is unfair to place the burden of deficit reduction on cigarette excise taxes. These taxes are regressive taxes because their impact is proportionally greater on persons with low and moderate incomes. Regressive taxes should not be utilized as a means either to recoup Federal deficits or to reduce by earmarking any specific programs such as Medicare. This latter point is true now more than ever because of the greatly improved financial situation in the Medicare trust fund. The impact of State excise tax increase. Even the Federal tax at 16 cents ignores the policy of leaving to the States any potential revenue to be derived beyond the basic 8 cent Federal excise tax. At least 16 States have already passed contingent tax increases based on the sunset provision. Eight States have pending contingent tax legislation. We recall that the administration several years ago had proposed an elimination of Federal cigarette excise taxes as part of its true federalism initiative by stating that such taxes should be State revenue options. Given the recent proposals to reduce revenue sharing and block grants and to eliminate deductions for State and local income taxes, it is important that some revenue generating areas be preserved for the States. Tobacco is unfairly singled out. Of the various excise taxes to be raised, tobacco was singled out for a substantial tax increase. We believe that excise taxes in general are repressive, but certainly tobacco should not be discriminated against. Thank you for this opportunity to present our views.

Senator CHAFEE. Thank you very much for that testimony from Mr. Giso.

[The prepared written statement of Mr. Giso follows:]

STATEMENT OF JACKIE GISO, PRESIDENT
JACKIE GISO, INC.,
CRANSTON, RHODE ISLAND

BEFORE THE
SENATE FINANCE COMMITTEE

ON

CIGARETTE EXCISE TAXES

SEPTEMBER 10, 1985

Mr. Chairman and members of the Committee. My name is Jackie Giso, President of Jackie Giso, Inc., a tobacco wholesale distribution company based in Cranston, Rhode Island.

I am a member of the National Association of Tobacco Distributors (NATD), which represents over 570 small business wholesaler-distributor members, with over 740 distribution outlets. Our Association also represents 230 manufacturer and supplier associate members whose 12,000 salesmen canvass and supply almost 1.5 million retail outlets selling tobacco products across the United States. Our industry markets goods with an estimated annual wholesale value of over $16 billion dollars.

We appreciate the opportunity to present NATD's position on whether the current level of federal cigarette excise tax should be extended beyond September 30, 1985. The NATD urges this Committee to comply with the intent of Public Law 97-248, the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), which contains a "sunset" provision that would reduce the tax rate from 16 cents to 8 cents per pack on October 1, 1985. In addition, we believe that the Committee should also adopt a floor stocks tax rebate provision, similar to the one considered for inclusion in last year's, Deficit Reduction Act of 1984 (P.L. 98-369), that would provide for refunds of 8 cents for every pack held in inventory on October 1, 1985.

I would like to emphasize some of our policy considerations regarding the sunset provision and rebates.

Rebates

In 1983, the TEFRA cigarette tax increase placed a significant burden on wholesalers because it included a floor stocks tax. According to the Treasury Department, the one-time tobacco floor stocks tax on inventory held on January 1, 1983 produced $180 million in revenue, all of which was paid by the tobacco wholesale industry. With the scheduled lowering of the federal cigarette excise tax, the opposite should occur. There should be a rebate of the taxes which have already been paid on inventory held on October 1, 1985. Legislative language should be included in the House and Senate tax bill, as was included by the House Ways and Means Committee last year, to include a floor stocks rebate for such inventory. At this time, Mr.Chairman, I would like to include in my testimony a copy of a letter which was sent by Steve Bloom, Chairman of the NATD's Legislative Committee and a member of the Executive Committee, to the Chairman of the House Ways and Means Committee, Congressman Dan Rostenkowski(D-Ill),outlining the floor stocks rebate language we support. We would urge you to include this language in Senate legislation prior to the end of this month.

Tobacco Excise Taxes Are Regressive

It is unfair to place the burden of deficit reduction on cigarette excise taxes. These taxes are regressive taxes because their impact is proportionally greater on persons with low and moderate incomes. Regressive taxes should not be utilized as a means either to recoup federal deficits, or to reduce through earmarking, any deficits in specific programs such as Medicare. This latter point is true now more than ever because of the greatly improved financial situation of the Medicare Trust Fund.

Impact Of State Excise Tax Increases

Keeping the federal excise tax at 16 cents ignores the policy of leaving to the states any potential revenue to be derived beyond the basic 8 cents federal excise tax. As least sixteen states have already passed contingent tax increases based on the sunset provision. Eight states have pending contingent tax legislation. We recall that the Administration several years ago had proposed an elimination of federal cigarette excise taxes as part of its "New Federalism" initiatives, by stating that such taxes should be State revenue options. Given recent proposals to reduce revenue sharing and block grants, and to eliminate deductions for state and local income taxes, it is important that some revenue-generating areas be preserved for States.

Tobacco Unfairly Singled Out

Of the various federal excise taxes which could be raised, tobacco was singled out for a substantial tax increase. We believe that excise taxes in several are repressive, but certainly tobacco should not be discriminated against.

Thank you for this opportunity to present our views.

THIS IS A COPY OF THE LAW AS IT WAS PASSED.

PART III—CIGARETTES

SEC. 283. INCREASE IN TAX ON CIGARETTES.

(a) RATE OF TAX.—Subsection (b) of section 5701 (relating to rate of tax on cigarettes) is amended—

(1) by striking out "$4" in paragraph (1) and inserting in lieu thereof "$8; and

(2) by striking out "8.40" in paragraph (2) and inserting in lieu thereof $16.80".

(b) FLOOR STOCKS.—

(1) IMPOSITION OF TAX.—On cigarettes manufactured in or imported into the United States which are removed before January 1, 1983, and held on such date for sale by any person, there shall be imposed the following taxes:

(A) SMALL CIGARETTES.—On cigarettes, weighing not more than 3 pounds per thousand, $4 per thousand;

(B) LARGE CIGARETTES.—On cigarettes, weighing more than 3 pounds per thousand $8.40 per thousand; except that, if more than 6½ inches in length, they shall be taxable at the rate prescribed for cigarettes weighing not more than 3 pounds per thousand, counting each 2¾ inches, or fraction thereof, of the length of each as one cigarette.

(2) LIABILITY FOR TAX AND METHOD OF PAYMENT.—

(A) LIABILITY FOR TAX.—A person holding cigarettes on January 1, 1983, to which any tax imposed by paragraph (1) applies shall be liable for such tax.

(B) METHOD OF PAYMENT.—The tax imposed by paragraph (1) shall be treated as a tax imposed under section 5701 and shall be due and payable on January 18, 1983 in the same manneras the tax imposed under such section is payable with respect to cigarettes removed on after January 1. 1983.

(3) CIGARETTE.—For purposes of this subsection, the term "cigarette" shall have the meaning given to such term by subsection (b) of section 5702 of the Internal Revenue Code of 1954.

(4) EXCEPTION FOR RETAILERS.—The taxes imposed by paragraph (1) shall not apply to cigarettes in retail stocks held on January 1, 1983, at the place where intended to be sold at retail.

(c) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to cigarettes removed after December 31, 1982 and before October 1, 1985.

PART IV—TAPS ADJUSTMENT ELIMINATED

VERSION 1

SEC. _________ TAX REBATE ON FLOOR STOCKS OF CIGARETTES

(a) QUALIFYING CIGARETTES - On cigarettes manufactured in or imported into the United States which are removed before October 1, 1985, and held on such date for sale by any person, shall qualify for the following rebates:

(1) SMALL CIGARETTES - On cigarettes, weighing not more than 3 pounds per thousand, ________ per thousand;

(2) LARGE CIGARETTES - On cigarettes, weighing more than 3 pounds per thousand ________ per thousand; except that, if more than 6 1/2 inches in length, they shall qualify for a rebate at the rate prescribed for cigarettes weighing not more than 3 pounds per thousand, counting each 2 3/4 inches, or fraction thereof, of the length of each as one cigarette.

(b) PERSONS QUALIFYING AND METHOD OF PAYMENT

(1) PERSONS QUALIFYING - A person holding cigarettes on October 1, 1985, to which any tax rebate described by paragraph (a) applies shall be entitled to such rebate.

(2) METHOD OF PAYMENT - The rebate described by paragraph (a) shall be due and payable on or before November 15, 1985.

(c) CIGARETTE - For purposes of this Subsection, the term "cigarette" shall have the meaning given to such term by Subsection (b) of Section 5702 of the Internal Revenue Code of 1954.

(d) EXCEPTION FOR RETAILERS - The rebate described by paragraph (a) shall not apply to cigarettes in retail stocks held on October 1, 1985, at the place where intended to be sold at retail.

Deficit Reduction Act of 1984
(Public Law 98-369)

Division A - Tax Reform Act of 1984
Title X - Miscellaneous Revenue Provisions
Subtitle B - Excise Tax Provisions
Part II - Other Excise Taxes

SEC. 1026. FLOOR STOCK REFUND FOR CIGARETTES.

(a) In General.—Where, before October 1, 1985, any article subject to tax under section 5701(b) of the Internal Revenue Code of 1954 has been sold by the manufacturer, producer, or importer and on such day is held for sale by any person (hereinafter in this section referred to as the "dealer"), there shall be credited or refunded (without interest) to the manufacturer, producer, or importer an amount equal to the excess of the tax paid by such manufacturer, producer, or importer on such article over the tax which would have been paid if such article were taxed at the rate in effect on October 1, 1985, if—

(1) claim for such credit or refund is filed with the Secretary before July 1, 1986, based on a request submitted to the manufacturer, producer, or importer before April 1, 1986, by the dealer who held the article in respect of which the credit or refund is claimed, and

(2) on or before July 1, 1986, reimbursement has been made to the dealer by the manufacturer, producer, or importer in an amount equal to such excess or written consent has been obtained from the dealer to the allowance of the credit or refund.

(b) Limitation on Eligibility for Credit or Refund.—No manufacturer, producer, or importer shall be entitled to a credit or refund under subsection (a) unless he has in his possession such evidence of the inventories with respect to which the credit or refund is claimed as may be required by regulations prescribed by the Secretary.

(c) Other Laws Applicable.—All provisions of law, including penalties, applicable with respect to the taxes imposed by section 5701 of such Code shall, insofar as applicable and not inconsistent with subsections (a) and (b) of this section, apply in respect of the credits and refunds provided for in subsection (a) to the same extent as if the credits or refunds constituted overpayments of the tax.

(d) Definitions.—For purposes of this section—

(1) Person.—The term "person" includes any State or political subdivision thereof, or any agency or instrumentality of a State or political subdivision thereof.

(2) Secretary.—The term "Secretary" means the Secretary of the Treasury or his delegate.

Source of this excerpt:

Conference Report on H.R. 4170
(H. Rept. No. 98-861)
Reprinted in Congressional Record (6/22/84) p. H6519

VERSION 2

NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS
REQUEST TO THE HOUSE WAYS AND MEANS COMMITTEE
SUGGESTED CHANGE TO SECTION 27, OF H.R. 4170
THE TAX REFORM ACT

MARCH 16, 1984

SECTION (d)(1)

p. 16 line 17

After "person" insert:
"at any place other than at the place where intended to be sold at retail"

p. 17 line 3

Replace "request" with "verified claim"

p. 18 line 16

After subsection (B) insert another definition:

"(C) VERIFIED CLAIM. -- The term 'verified claim' means any claim submitted by any dealer to any manufacturer, producer, or importer which complies with Section (d)(2).

p. 17 line 20

After Section (d)(2) insert a new section (d)(3) and renumber subsequent sections accordingly:

"(3) MANDATORY REFUNDS TO DEALERS. -- Upon receipt of a verified claim, a manufacturer, producer, or importer shall reimburse the dealer which submitted such verified claim within 10 days of receipt of such verified claim; such refund to be in cash or, at the option of dealer, in credit or in any other means acceptable to dealer.

insert in lieu thereof "issued in connection with".

(147) In section (d) of section 632 of the bill—

(A) strike out "were issued with respect to" and insert in lieu thereof "are issued with respect to", and

(B) strike out "or any facility related to such facility".

(148) In subsection (b) of section 644 of the bill, strike out "take into account in 1984" and insert in lieu thereof "use in 1984".

(149) In subsection (a) of section 648 of the bill, strike out "a hearing and".

(150) In section 647 of the bill, strike out "any other provision of law" and insert in lieu thereof "any other provision of law, in the case of obligations issued before July 1, 1987".

(151) In paragraph (3) of section 712(k) of the bill, strike out subparagraph (B) and insert in lieu thereof the following:

(B) by inserting "or" at the end of subparagraph (C), and

(152) In paragraph (2) of section 1362(e) of the Code, as amended by section 721(g)(3) of the bill, strike out "paragraphs (3) and (6)(C)" and insert in lieu thereof "paragraph (3) and subparagraphs (C) and (D) of paragraph (6)".

(153) In subsection (a) of section 518 of the Highway Revenue Act of 1982, as amended by section 734(i) of the bill, insert ", except as provided in regulations prescribed by the Secretary of the Treasury or his delegate," before "any Federal Reserve Bank".

(154) In paragraph (2) of section 921(d) of the Code (as added by section 801 of the bill), insert "or accured" after "received".

(155) In paragraph (3) of section 921([illegible] of the Code (as added by section 801(a) of the bill), insert "or accured" after "received".

(156) In section 921(d) of the Code (as added by section 801(a)) strike out "the conduct of" in the matter following paragraph (3).

(157) In clause (i) of section 922(a)([illegible])(D) (as added by section 801(a) of the bill), insert before the comma at the end thereof "or in any possession of the United States".

(158) In the last sentence of section 924([illegible] of the Code (as added by section 801(a) of the bill), insert "derived" before "from activities".

(159) In paragraph (3) of section 927(e) of the Code (as added by section 801(a) of the bill) strike out "credited or organized" and insert in lieu thereof "created or organized".

(160) In section 927(e) of the Code (as added by section 801(a) of the bill), strike out paragraph (5) and insert:

"(5) Exemption from certain other taxes.—No tax shall be imposed by any jurisdiction described in subsection (d)(5) on any foreign trade income derived before January 1, 1987.

(161) In section 801(d) of the bill, add at the end thereof the following new paragraphs:

(11) Section 936(f) (relating to DISC or former DISC ineligible for credit) is amended to read as follows:

"(F) LIMITATION ON CREDIT FOR DISCs AND FSCs.—NO CREDIT SHALL BE ALLOWED UNDER THIS SECTION TO A CORPORATION FOR ANY TAXABLE YEAR—

"(1) for which it is a DISC or former DISC, or

"(2) in which it owns at any time stock in a—

"(A) DISC or former DISC, or

"(B) FSC or former FSC."

(12) Section 6011(c) (relating to returns of DISCs and former DISCs) in amended—

(A) by inserting "or a FSC of former FSC" after "former DISC" in paragraph (1), and

(B) by inserting "and FSCs and Former FSCs" after "Former DISCs" in the heading thereof.

(13) Section 6072(c) (relating to returns by nonresident alien individuals and foreign corporations) is amended by inserting "or a FSC or former FSC" after "United States".

(14) Section 6501 (g)(3) (relating to income tax returns of DISCs) is amended by striking out "section 6011(e)(2)" and inserting in lieu thereof "section 6011(c)(2)".

(15)(A) Section 6686 (relating to failure of DISC to file returns) is amended—

(i) by striking out "section 6011(e)" and inserting in lieu thereof "section 6011(c)", and

(ii) by striking out the heading thereof and inserting in lieu thereof the following:

"SEC. 6686. FAILURE TO FILE RETURNS OR SUPPLY INFORMATION BY DISC OR FSC."

(B) The table of sections for subchapter B of chapter 68 is amended by striking out the item relating to section 6686 and inserting in lieu thereof the following new item:

"SEC. 6686. FAILURE TO FILE RETURNS OR SUPPLY INFORMATION BY DISC OR FSC."

(162) Section 995(f)(3) (as added by section 802(a)(3)) is amended by striking out "and carrybacks of losses and credits".

(163) In section 805(b)(2)(A) of the bill, insert "with respect to which there had previously been a deemed distribution to which section 996(e)(1) of such Code applied" immediately before the period at the end thereof.

(164) In paragraph (2) of section 4051(d) of the Code, as amended by section 921 of the bill, strike out subparagraph (B) and insert in lieu thereof the following:

"(B)(i) both the seller and the purchaser of which are registered in a manner similar to registration under section 4222, and

"(ii) with respect to which the purchaser certifies (at such time and in such form and manner as the Secretary prescribes by regulations) to the seller that such trailer or semitrailer—

"(I) will be used, or resold for use, principally in connection with such service, or

"(II) will be incorporated into an article which will be so used or resold."

(165) Strike out section 1020 of the bill.

(166) Strike out the item relating to section 1020 in the table of contents of the bill.

(167) In clause (iii) of section 6166(b)(9)(B) of the Code, as added by section 1021 of the bill, insert before the period at the end of the first sentence "for purposes of clause (ii)".

(168) In clause (i) of section 1034(c)(2)(B) of the bill, strike out "account of interest" and insert in lieu thereof "number of units".

(169) In clause (iii) of section 1034(c)(2)(B) of the bill, strike out "amount of interests" and insert in lieu thereof "number of units".

(170) In subsection (j) of section 51 of the Code, as added by subsection (c) of section 1041 of the bill—

(A) strike out "allowable under section 44B" in paragraph (1) thereof and insert in lieu thereof "under this section", and

(B) strike out "allowed under section 44B" in paragraph (2) thereof and insert in lieu thereof "determined under this section".

(171) In paragraph (1) of section 1072(c) of the bill, strike out "section 6050(c)" and insert in lieu thereof "section 6053(c)".

(172) In section 1079 of the bill, strike out all that follows the parenthetical material and insert in lieu thereof ", as amended by section 2813 of the bill, is amended by striking out subparagraph (A) thereof and inserting in lieu thereof the following:

"(A) is exempt from Federal income taxes—

"(i) under such Act as amended and supplemented before the date of the enactment of the Tax Reform Act of 1984, or

"(ii) under this title without regard to any provision of law which is not contained in this title and which is not contained in a revenue Act, or

(173) Section 217 of the bill is amended by adding at the end thereof the following new subsection:

(n) SPECIAL RULE FOR COMPANIES USING NET LEVEL RESERVE METHOD FOR NONCANCELLABLE ACCIDENT AND HEALTH INSURANCE CONTRACTS.—A company shall be treated as meeting the requirement of section 807(d)(3)(A)(iii) of the Internal Revenue Code of 1954, as amended by this Act, with respect to any noncancellable accident and health insurance contract for any taxable year if such company—

(1) uses the net level reserve method to compute its tax reserves under section 807 of such Code on such contracts for such taxable year,

(2) was using the net level reserve method to compute its statutory reserves on such contracts as of December 31, 1982, and

(3) has continuously used such method for computing such reserves on such contracts after December 31, 1982, and through such taxable year.

(174) In section 521 of the bill redesignate subsection (d) as subsection (e) and insert after subsection (c) the following new subsection:

(d) CERTAIN DISTRIBUTION REQUIREMENTS TO APPLY TO 5-PERCENT OWNERS RATHER THAN KEY EMPLOYEES.—Section 72(m)(6) (relating to penalties applicable to certain amounts received by owner-employees) is amended—

(1) by striking out "key employee" each place it appears in subparagraph (A) and inserting in lieu thereof "5-percent owner";

(2) by striking out "in a top-heavy plan" in clause (i) of subparagraph (A), and

(3) by striking out "the terms 'key employee' and 'top-heavy plan'" in subparagraph (C) and inserting in lieu thereof "the term '5-percent owner'".

(175) In section 168(b)(4)(A) of the Code (as added by section 111(b)(1) of the bill), insert "(without regard to the mid-month convention)" after "paragraph (3)" in the matter preceding clause (i).

(176) In paragraphs (2) and (3)(C) of section 1042(b) of the Code (as added by section 541(a) of the bill), strike out "qualified securities" and insert "employer securities (within the meaning of section 409(1)".

(177) In section 4978 of the Code (as added by section 545(a))—

(A) strike out "qualified securities" in paragraph (1) of subsection (a) and insert "employer securities",

(B) strike out "qualified securities" the second place it appears in paragraph (2) of subsection (a) and insert "employer securities".

(C) amend subsection (e)(1) to read as follows:

"(1) EMPLOYEE STOCK OWNERSHIP PLAN.—The term 'employee stock ownership plan' has the meaning given to such term by section 4975 (e)(7).",

(D) strike out the closing quotation marks at the end of subsection (e)(4), and

(E) insert at the end of subsection (e) the following:

"(5) EMPLOYER SECURITIES.—The term 'employer securities' has the meaning given to such term by section 409 (1).".

(178) In section 1278(a)(2)(A) of the Code (as added by section 41(a) of the bill), insert "(determined without regard to paragraph (2) thereof)" after "section 1272(a)".

(179) In section 48(a)(5)(B)(ii)(II) of the Code (as amended by section 31(b) of the bill), strike out "section 48(a)(2)(B)(vi)" and insert "section 48(a)(2)(B)(v)".

Senator CHAFEE. Gentlemen, here is the problem. None of us on this committee want to hurt anybody. We don't want to hurt farmers, particularly small farmers, small retailers, and those involved in family owned businesses. What do you say, though, about the connection between tobacco and smoking and health? I mean, if anybody wants to argue that, I would be interested in hearing it; but it seems to me it is absolutely clear that smoking is bad for every health problem that humans have. It has a synergistic effect with strokes, with lung problems, with blood pressure. Whatever the problem, if you add smoking it is compounded. These problems have cost implications. The previous witnesses said that there is a $14 billion added cost to direct health costs to the Federal Government, plus $25 billion of lost time due to related sicknesses. Now, furthermore, there has been testimony—indeed, your own testimonies—shows that the increase in the tax by 8 cents resulted in a 6-percent decline in smoking, and I think those are your figures, Mr. Kornegay. Now, what about all that? Suppose you were sitting in our seats up here, what is your answer? Let's take you, Mr. Kornegay.

Mr. KORNEGAY. Oh, me first?

Senator CHAFEE. We are not looking at this issue as simply trying to legislate social behavior. Rather we are attempting to introduce some equity into our health system—people who smoke should pay for some of the costs they impose on the rest of society. And as you yourselves stated—presumably if 6 percent fewer people are smoking, then the costs of cigarette-related diseases has decreased by 6 percent.

Mr. KORNEGAY. Our position is quite clear, Mr. Chairman, I think, and plain, and that is this is the tax writing committee for the country. Looking at it from your perspective, as I perceive it anyway, your responsibility is raise the revenues to run the Federal Government, and to do this, in an objective way, by being fair, avoiding regressivity if possible, and in a way that will encourage economic growth. If you follow those principles, the principles which have been laid out by those in the Congress and in the country who are interested in tax reform, you would let this sunset take effect. Now, I understand why and how, after listening to the previous panel, you and other members of the subcommittee would be concerned. I want to be fair to them because I know them to be conscientious people. You have got to view their position and their testimony, in light of their mission, and that is to bring about a smokeless society. They are—and I use this word charitably, I hope—prohibitionists. We are not. We view tobacco as a legal product, one of the first exports this country ever had. And of course, we get emotional and they get emotional. They are, I am sure, convinced that anybody who smokes a cigarette is hurting his health and that it is going to cause great grief to many people. Our view is that their testimony should be presented, as it has been on many occasions, before other forums in the Congress. The Commerce Committee has held hearing after hearing on the health questions, and this is where health policy matters related to smoking ought to be determined. Congress said look to the tobacco industry—3 years ago—for more revenue. Help us out. We are going to double the excise tax, but at the end of 3 years, we will let it go back to where it used to be. Now, I am not saying we liked that, but we didn't accept it grudgingly, and we are simply here saying: Please give us a little help. And we think we can demonstrate with positive proof the damage that has been done principally to the farmer in the tobacco industry, as well as the distributors. And yes, it has affected the manufacturers, too, to some extent.

Senator CHAFEE. As you know, Mr. Kornegay, this is more than just a tax-writing committee. This committee has jurisdiction over series of areas, and other considerations than revenue come in. The whole problem of protectionism isn't to get more revenue for the Federal Government. It is to keep imports out. So, that is not just a revenue matter. And we are dealing with Medicare and Medicaid, which are under the jurisdiction of this committee as well.

Mr. KORNEGAY. Yes.

Senator CHAFEE. Mr. Carter, let me ask you a question. You are right on the front lines. You have a tobacco farm. I think you said—how big is it?

Mr. CARTER. Fifty-five acres.

Senator CHAFEE. Fifty-five? How big is it?

Mr. CARTER. Fifty-five acres.

Senator CHAFEE. Fifty-five acres of tobacco. And in your testimony, you pointed out—or maybe it was some earlier witness—that starting in about the late 1970's, the decline of the tobacco farms began. What is the future? Regardless of what we do here, it seems to me that the future of the tobacco farmer probably isn't the best in the world, is it?

Mr. CARTER. Mr. Chafee, I grow several other crops besides tobacco, and the future of those commodities is somewhat bleak at this time also. Yes, I think the tobacco farmer has a future. We have some program adjustments, as Senator Helms alluded to this morning, that have to be made to make ourselves more price competitive in a world market. I would certainly like to think as a tobacco farmer that I do have a future. I also would like to point out that the gentleman on the Coalition of Smoking or Health was talking about substitutions and that the day of the tobacco farmer has come, and there is no substitute for tobacco in the State of North Carolina. We could devastate any specialty market that you could so name—strawberries, be what it may, asparagus—and glut that market within a very short period of time. Those acres and those people who are currently employing people, keeping those people off of welfare rolls, giving those people work, would be out of jobs. They would become not employees any more, and those people consequently would be looking elsewhere.

Senator CHAFEE. But isn't it true that even before this tax increase came along, that the purchase power of the Government of tobacco had reached or was on its way to reaching unprecedented levels. And I think now the holdings of the Stabilization Cooperative, I guess you said, are at an all-time high. Are you attributing that to the tax?

Mr. CARTER. Not entirely, but to a great extent. As I said, 18 to 21 percent of it would be at any rate.

Senator CHAFEE. Was it your testimony, Mr. Kornegay, where you went into the discussion of the farmers and the decline of the——

Mr. **Kornegay**. Let me see, Mr. Chairman, if I can make a statement. Everybody in the industry, in the entire tobacco family, will probably not agree with this.

Senator **Chafee**. Let me just go over your statistics starting at the bottom of page 5:

> Between 1978 and 1982, chronic adversity in this sector—naming agriculture, namely tobacco—was manifested by a steep reduction in the number of farms producing tobacco in several States.

That was long before we did anything about this tax.

Mr. **Kornegay**. Would you like for me to give you my personal views?

Senator **Chafee**. Yes. Could you answer that?

Mr. **Kornegay**. About 1977, in that time period, under the tobacco support program, the support price or the loan rates as they call it were increased every year. They went up, up, up. And at about that point was where the law of economics set in. Athough American tobacco is by far the premium tobacco of the world—quality tobacco—and our foreign buyers for years would pay more to get the quality, they would only pay so much more. So, when the escalating increased price got to a certain point, that is when these foreign countries, some of whom were named this morning—Brazil—talking about Flue-cured and burley—Brazil, Korea, Zimbabwe, Malawi, with reference to Flue-cured—that is when they really got into the market. Now, I understand they have improved their quality to some extent, and we have lost a lot of our foreign customers. For example, in the late 1950's the United States supplied 60 percent of the Flue-cured tobacco for the world. Today, it is approximately 25 percent. We have lost a large share of our foreign markets; and that is where one of the real griefs for the industry has come. They were declining as a result of the high support prices Mr. Chairman, and then when the tax was doubled, it was so sudden—it just hit bam—right overnight and caused a precipitous drop in sales, in the 5-, 6-, and 7-percent area.

Senator **Chafee**. It seems to me from your statistics you say, that during 1978–82, long before this tax came along, the number of tobacco farms in North Carolina decreased by 26 percent, in South Carolina by 33 percent, in Georgia by 31 percent, in Maryland by 21 percent, in Virginia by 18 percent. Those are walloping, staggering figures.

Mr. **Kornegay**. Yes, sir.

Senator **Chafee**. When something goes down by 33 percent or 31 percent, especially in North Carolina which is looked on as sort of the capital of the industry with a drop of 26 percent, it seems to me that the whole tobacco growing industry has just got a host of problems. It is similar to the whole American farm sector problem which seems at least closely related to the price supports. They are pricing themselves right out of the market.

Mr. **Kornegay**. That is exactly right, Senator.

Senator **Chafee**. So, I think to lay it at the foot of an 8 cent tax is perhaps not accurate.

Mr. **Kornegay**. I am not laying all of the problems on the tax. There are many problems. Of course, we normally address them one at a time, and we are here today hopefully to convince you and members of the subcommittee that we do need some help, in this tax area. Tax relief would not solve all of our problems by any means.

Senator **Chafee**. Senator Bradley.

Senator **Bradley**. Thank you very much, Mr. Chairman. I would like to thank the panel for their testimony. I found it very informative, and there are a couple of areas I would like to pursue. First, Mr. Kornegay, you made a point in your presentation that there shouldn't be any tax increase and this is a tax increase any way you cut it. You quote the majority leader. Let me ask you this: As a citizen, the Superfund, which is the bill to clean up toxic wastes, expires September 30. Do you think we should renew that, as a citizen? I mean, you want to get toxic waste cleaned up?

Mr. **Kornegay**. I certainly do, Senator. There is no question about it.

Senator **Bradley**. That would mean that the Congress would have to impose taxes to clean up the toxic wastes.

Mr. **Kornegay**. I am no expert on the Superfund. I know of it, and I have certainly heard about it.

Senator **Bradley**. But as a citizen, you would like to see it cleaned up?

Mr. **Kornegay**. But as a citizen, of course, I support an effort to clean up our rivers, streams, and our air. There is no question about that.

Senator **Bradley**. All right.

Mr. **Kornegay**. As I understand it, the Superfund Program is coming up for renewal with a financing mechanism attached to it.

Senator **Bradley**. Except that the administration is suggesting $5 billion, and this committee passed $7.5 billion as opposed to $1.6 billion. So, it is a tax increase.

Mr. **Kornegay**. If there is a tax connected with it.

Senator **Bradley**. Let me go on. In 1982, we passed TEFRA, and this increase in the cigarette tax from 8 to 16 cents was part of this bill. TEFRA over 3 years raised about $100 billion, part of which is related to the cigarette tax. You are now recommending that we essentially let the cigarette tax return to 8 cents. Do you think we should repeal the rest of the provisions in TEFRA that we passed to raise revenue?

Mr. **Kornegay**. I would not—don't think I am really qualified to say. I haven't made a study of it. Any of them that were considered as being temporary, then I would suggest that the Congress ought to let them go by the boards.

Senator **Bradley**. But you do think yours ought to be repealed, if others aren't? Obviously, that is what you are saying.

Mr. **Kornegay**. We are saying just don't do anything, for the Congress decided that it would go off automatically at the end of this fiscal year. And if you just don't do anything, then it will go off. And so, we are not asking you to take any action now. Letting this tax sunset does not result in the termination of any Government program.

Senator **Bradley**. All right.

Mr. **Kornegay**. The wholesaler has another very substantial problem.

Senator **Bradley**. Now, I was curious to follow up on Senator Chafee's comment about the decline in the number of tobacco farms in North Carolina between 1978 and 1982. And it was a 26-percent decline. What are those people doing now?

Mr. **Kornegay**. I don't know that I could answer—just general knowledge. They have probably gone to work in a plant. Some of them are living on public assistance.

Senator **Bradley**. So, most have jobs?

Mr. **Kornegay**. I don't know. I would really defer that, Senator Bradley, to Mr. Carter who is right down there every day working and knows the people.

Mr. **Carter**. Senator, I wanted to say that since 1975, the effective quota for Flue-cured tobacco is about 50 percent in 1985 of what it was in 1975, which would say that there is going to be less tobacco farmers, or at least half as small as they were at one time. There are a lot of tobacco farmers who have gone out of business. Some of them are still farming, only they don't grow tobacco now. Tobacco is such a labor-intensive problem that any time someone doesn't grow it any more, it does away with jobs for other people in the communities.

Senator **Bradley**. But what I am trying to figure out is: From 1978 to 1982, we lost 26 percent of the farmers in North Carolina according to the testimony of Mr. Kornegay. The unemployment rate in North Carolina as of May 1985 was 5.4 percent, which is way under the national average of 7.3 percent, so most of these people must have gotten jobs somewhere. So, they are obviously working, or the unemployment rate would be higher. So, I think there is a burden of proof here that even if 8 cents more on a pack of cigarettes would be detrimental, that this means that the people would be on public assistance. They haven't been since 1982. You have an unemployment rate of 5.4 percent.

Now, if I could just quickly pursue a couple of other areas. You are concerned about imports. Is that right? I didn't hear a lot of emphasis on that, but are you concerned about imports?

Mr. **Kornegay**. Let me say this, Senator, and then they can all choose up and give their views. Imports are a subject that you do not find unanimity on within the tobacco industry.

Senator **Bradley**. All right, but you are concerned about imports, and obviously earlier there was eloquent testimony about the concern of imports. Keeping the cigarette tax at 16 cents instead of 8 cents could be totally offset by an 8 percent decline in the value of the dollar. What you are worried about is imports. The price of an import would be totally offset by the increase in the cigarette tax if you had a decrease in the value of the dollar. So, I think that that argument again bears closer scrutiny.

Now, the bell has rung, and I just want to pursue one other point. I thought Mr. Carter's testimony was frankly very direct and very moving. I just want to clarify one thing, though, that came out in the earlier questions. You say that you farm 55 acres?

Mr. **Carter**. Yes, sir.

Senator **Bradley**. Do you farm other crops?

Mr. **Carter**. Yes, sir.

Senator **Bradley**. What is your total acreage that you farm?

Mr. **Carter**. 2,000 acres.

Senator **Bradley**. 2,000 acres? So, out of the 2,000 acres, you farm 55 acres of tobacco?

Mr. **Carter**. Yes, sir.

Senator **Bradley**. Would you call yourself a small tobacco farmer then?

Mr. **Carter**. No, sir; That tobacco produces 25 percent of the income of those 2,000 acres.

Senator **Bradley**. All right. Now, if you are concerned about the plight of tobacco farmers, and I am saying that I want to be sensitive to that, what do you see happening? Mr. Chairman, I don't want to take more time, but how does this tobacco program actually work? You have your 55 acres, and you pay your $500 an acre. What do you get? How does the program work?

Mr. **Carter**. You want me to explain the tobacco part?

Senator **Bradley**. Yes, for the record.

Mr. **Carter**. Tobacco is under Federal legislation a suppliers control. The price for it is controlled; and to grow a pound of tobacco in the United States, you must have a pound of quota.

Senator **Bradley**. I'm sorry?

Mr. **Carter**. To sell a pound of tobacco in the United States, you must have a pound of quota which is that pound that has been allocated to the farm, and you can come by that pound of quota in several different ways. You can purchase it. You can lease it from someone. You may already own it. This tobacco is grown by you under the control system. It is placed on a market. It has a support price which is very detailed and hard to explain, other than the many grades involved in the system, and one grade being a better grade than the other and the price consequently being higher. This is placed for sale at a company or a buyer pays more than the support price, and he purchases the tobacco. If not, it goes into the Stabilization Corporation, which is contracted a commodity credit to carry out the laws that have been passed by our Congress. This tobacco then, since 1982, is the responsibility of those people who are growing tobacco. If there is a cost of carrying this inventory, it will be assessed on the quota for the following year, which currently this year it cost me 25 cents a pound for every pound of tobacco I sell to carry inventories prior to 1985. These figures are forecast to be even higher than that in years coming. I am sure you don't understand the program from what I have said, but briefly, that is the way the program works.

Senator **Chafee**. Can you sell it for less than the price?

Mr. **Carter**. If the grower subsidizes the price, he can. No, no; not on the auction market.

Senator **Bradley**. Let me try to go through this once more, just to make it clear for the record, and make it clear also for a nontobacco farmer. You grow some tobacco. The Government says they will buy the tobacco if it exceeds a certain price?

Mr. **Carter**. No, sir.

Senator **Bradley**. Or if it is below a certain price?

Mr. **Carter**. If it is not purchased at a certain price.

Senator **Bradley**. If it is not purchased at a certain price, the Government will buy it?

Mr. CARTER. The concept being the same as the minimum grower owns feed grains and other commodities produced in the United States.

Senator BRADLEY. All right. Now, you produce your crop, and it is below the market price. Where do you take your tobacco to sell it?

Mr. CARTER. It is sold at the time that it is placed on the warehouse floor. The buyer is the only thing that is in question. If it goes into the grower-supported cooperative, you know it is picked up just as if it would be if a buyer had purchased it. And it goes into the warehouses in the Raleigh, NC area, which we have 805 million pounds.

Senator BRADLEY. Are those buyer warehouses meeting private sector purchases or Government purchases?

Mr. CARTER. They are Government purchases stored in Government-leased storage facilities.

Senator BRADLEY. So, you sell to Government warehouses and they store the tobacco?

Mr. CARTER. No, sir; the warehouse system is such that in each major tobacco-producing area, there is a tobacco market system which is a private business who runs a warehouse for the purpose of selling tobacco. I take my tobacco to his warehouse. He supplies an auctioneer. The buying interests supply a buyer or representative. It is graded by USDA graders prior to sale, and it establishes the price of that particular pile of tobacco. The sale then comes through, with the buyers and the auctioneer, and it is auctioned off. Then, it is going to the buyer or to the Government-owned warehouse, or wherever it might go.

Senator BRADLEY. So, the Government is one of the buyers if there is no private buyer?

Mr. CARTER. No, sir; the Government is not a buyer. They offer price support loans at a specified level. If that pile does not bring that level, then I am better off to put my tobacco in loan and hopefully sell it for a profit at a later date.

Senator BRADLEY. And where does the interest come in?

Mr. CARTER. The interest comes from the money that we have to borrow from Commodity Credit and the Federal compost to advance the farmer that loan. And in the case of tobacco we have to pay that interest. And if the commodity is not sold for enough to repay the loan, then we have to cover that portion also.

Senator BRADLEY. And what is the $500 an acre?

Mr. CARTER. The $500 an acre assessment is that amount which I have paid on this year's crop to store, finance, and pay interest on previous crops since 1982.

Senator BRADLEY. I see. So, when you say inventory is at an all-time high and interest charges having to pay the Commodity Credit Corporation of those stocks threaten to bankrupt our program, what do you mean by that?

Mr. CARTER. I mean that the tobacco farmer is to the point that he may very well in February vote that we do not want a Federal tobacco program any more, at which time Commodity Credit would own a great deal of tobacco that would bankrupt our program.

Senator CHAFEE. You mean if they went to sell it?

Mr. CARTER. Sir?

Senator **Bradley**. If they sold it?

Senator **Chafee**. Suppose the Government wants to get rid of it? Wouldn't it devastate the market?

Mr. **Carter**. Certainly, it would.

Senator **Bradley**. Is that what you mean when you say "bankrupt our program?"

Mr. **Carter**. Yes; in two senses of the word, I mean bankrupt. I mean from the weight of the carrying and the cost of it, which does not cost the Federal Government. I mean, the tobacco farmer is paying for that. And from the effect of that large inventory being over the heads of any other future crops, and the pressures of that supply versus what you are producing now.

Senator **Bradley**. And another point is that you say there are thousands of tobacco farmers who, because of the quota cuts and the increasing assessments, are being forced to leave the farm and seek other employment. Quota cuts?

Mr. **Carter**. Yes, sir; this is the quota which is established under the tobacco program that I said a few minutes ago that, in 1975, it was 1.5 billion pounds. In 1985, the effective quota is about 800 million pounds. So, effectively, it is 50 percent of what it was in 1975.

Senator **Bradley**. And increasing the assessment to $500?

Mr. **Carter**. Right.

Senator **Bradley**. Gentlemen, I thank you for your patience in allowing me to use this hearing not only to deal with taxes but to learn a little more in depth about the tobacco program. It seems to me that we have a choice here between letting the tax fall back to 8 cents and paying more for health care, even more than the $40 billion that is now paid, and letting the deficit go up; or letting the tax stay at 16 cents, doing something about the value of the dollar, reducing some consumption, reducing the ultimate of $40 billion in health care costs, and getting the deficit down. It seems to me that those are the two things that we have to weigh, and it has been a very informative panel.

Senator **Chafee**. All right. Thank you very much, gentlemen, for coming. We appreciate it.

Mr. **Kornegay**. Mr. Chairman.

Senator **Chafee**. Yes, Mr. Kornegay.

Mr. **Kornegay**. May I ask that the record include a few editorials from economists who speak on the subject? I think it would also be interesting to the committee to have included in the record a list of the 50 States, and the level of taxes now being charged in each State.

Senator **Chafee**. All right. We will pick these up now for the record and make sure those go in.

Mr. **Kornegay**. Thank you very much, Mr. Chairman.

Senator **Chafee**. Mr. Kornegay, if you will give that material to the gentlemen with you there.

Mr. **Kornegay**. I certainly will.

Senator **Chafee**. Thank you. The next panel is Dr. Loyd, Dr. Warner, and Dr. Scott, and Mr. Paul Knott. Let me again say for the record, so you will all know, in the last panel Mr. Kerrigan of the Smokeless Tobacco Council was absent. He had been listed. We will arrange for him to appear at a subsequent time. All right, gentlemen, let's move right along because we are going to quit at 12:30. Dr. Loyd.

[The economists' editorials and the list of taxes being assessed by the 50 States follow:]

ECONOMIC ANALYSIS OF PROPOSALS TO IMPOSE A FEDERAL EXCISE TAX ON SMOKELESS TOBACCO PRODUCTS

(Prepared by Dr. Robert D. Tollison, Center for Study of Public Choice, George Mason University, August 1985)

I. INTRODUCTION

At least three legislative proposals which would impose federal excise taxes on chewing tobacco and snuff are currently being considered by Congress. One bill, H.R. 3064 introduced by Representative Tauke, calls for an excise tax in the amount of 16 cents per ounce; another, H.R. 3078 by Representative Collins, would levy an excise of 32 cents per ounce. In addition, the Collins bill seeks to restrict the advertising of smokeless tobacco products by denying any income tax deduction to producers for expenditures made for such purposes. Senator Chaffee may also be planning to introduce smokeless tobacco legislation.

Ironically, these legislative proposals have surfaced within weeks of the twentieth anniversary of the Excise Tax Reduction Act of 1965 (P.L. 89-44), which among its other provisions, abolished the then 10 cents per pound tax on manufactured tobacco. The principle reason for abolishing the manufactured tobacco tax was a recognition by Congress of its extreme regressivity. Evidence presented at the various hearings on P.L. 89-44 suggested that the levy on manufactured tobacco was the most regressive of the federal excise taxes then in effect.

What differentiates the current excise tax proposals from their predecessor are the magnitudes of the tax rate that would be imposed if any of the bills were enacted. For example, if the 1965 excise on smokeless tobacco was simply reintroduced in terms of current dollars, the tax rate would be set at 24 cents per pound, or 1.5 cents per ounce, not in the range of 16 to 32 cents per ounce. The tax rates now under discussion are ten to twenty times the 1965 level, suggesting that the bills are not designed to raise revenue, but rather to punish the smokeless tobacco industry. When compared with the old federal excise tax on manufactured tobacco, with the rates levied by the states which tax these products, or with the prevailing federal excises on other goods such as beer, wine, gasoline, and cigarettes, the proposed federal excise on smokeless tobacco can only be described as a bankruptcy tax.

The confiscatory nature of the proposed tax becomes even more apparent when measured against the sales revenue currently generated by the smokeless tobacco industry. The $350 million in tax receipts which some have argued would be raised by the levy represents half of annual industry sales. It is inconceivable that the industry could survive such a burden, expecially in view of the fact that the companies which manufacture smokeless tobacco products are already good taxpayers. In contrast to many other business firms, the smokeless tobacco industry faces a tax rate on corporate income of about 40 percent.

The Congress must consider the economic and social implications of these new excise tax proposals, the costs and benefits expected to accrue to all affected parties, and the broad questions concerning the proper role of government and government regulation of individual behavior before reaching a final decision.

This study will review these major issues. Specifically, the following report considers the incidence of the proposed smokeless tobacco tax against the widely-accepted standards of horizontal and vertical equity in taxation and finds that the burden of an excise tax on chewing tobacco and snuff would fall most heavily on those individuals at the lower end of the income distribution, meaning that the proposed tax is regressive and violates the principle that taxes should be levied on the basis of ability to pay. In addition, excise taxes always distort economic efficiency -- they cost jobs in the economy.

Next, this report reviews the various proposals to earmark some or all of the revenues generated by the proposed tax for specific programs such as Medicare and Medicaid, or for publicity campaigns on the alleged health consequences associated with the use of smokeless tobacco products. It is shown that the main premise of such earmarking proposals is faulty, and results from a confusion between private costs and social costs.

This study also offers comments on the issue of federalism -- whether or not it is appropriate for the federal government to encroach on a tax revenue source already tapped at the state level -- and argues that if despite the lack of justification a tax on smokeless tobacco is enacted, it should take account of the fact that chewing tobacco and snuff are normally purchased in packages of different net weight. Congress should apply different tax rates to the two tobacco products.

In sum, this report concludes that the proposals for levying a tax on smokeless tobacco should be opposed for reasons which come under the general heading of fairness and economic efficiency. It is the purpose of this report to lay out a comprehensive set of arguments concerning why there is no reasonable basis for placing a federal excise tax on chewing tobacco and snuff.

II. EQUITY AND EFFICIENCY OF TAXES ON SMOKELESS TOBACCO

Federal excise taxes on smokeless tobacco products would push our tax structure further in the direction of inequities and inefficiencies of the type which are increasingly being recognized as unacceptable. Our existing tax system imposes burdens which have nothing to do with the benefits received for government services or with the ability to pay. Tax policy increasingly discriminates against particular income classes and groups for no other reason than that they have neither the financial resources nor the political influence to avoid them. By disproportionately burdening some activities while exempting others, our tax system is distorting economic decisions at all levels and reducing the ability of our economy to satisfy the demands of consumers efficiently.

It is these inequities and inefficiencies generated by our federal tax system which explains the interest currently being expressed in Congress over tax reform. The goal of tax reform is to increase the efficiency and fairness of the tax code, and the modified flat rate proposals currently being considered by Congress would go a long way toward realizing this goal. By broadening the tax base and lowering tax rates, efficiency is served by reducing both the incentive and opportunity to make economic decisions which are profitable at the private level but wasteful at the social level. Basic fairness would be served by a modified flat rate tax since the removal of tax loopholes would make it less likely that some will bear heavier tax burdens than others who are similarly situated.

It is difficult to understand how Congress, which is considering tax reform seriously, can at the same time take seriously proposals to reimpose an excise tax on snuff and chewing tobacco. Such a tax would exacerbate exactly the type of economic perversities which those behind the tax reform movement are hoping to reduce. Rather than closing off special-interest tax preferences and thereby allowing the tax burden to be spread more lightly over all economic activities, an excise tax on smokeless products would single out a narrow category of products and impose a discriminatory tax burden on them. Tax reform is aimed at allievating the tax burden precisely on the type of citizen represented by the average consumer of smokeless tobacco.

Excise Taxes and Economic Efficiency

In addition to the blatant unfairness of such a tax, it also inserts a "wedge" between the price paid by those who wish to consume smokeless tobacco products and the price received by producers. Faced with the resultant higher prices, consumers will cut back on their use of smokeless tobacco. Faced with a decline in sales, suppliers will layoff workers and spend less on other inputs as they reduce production. This requires that the discharged productive resources seek employment elsewhere in the economy where, even when successfully re-employed, they will end up producing products which consumers value less than the goods they would have purchased in the absence of the discriminatory excise tax. The result is a misallocation of productive resources in the economy, which means a reduction in our economic productivity and a deadweight loss to society. And unlike the revenues raised by the tax, this deadweight loss is not simply a transfer of wealth from one group in the society to another by way of the government. Instead, it represents a real loss of wealth, that is, the productive capacity of the economy is permanently lower than it would otherwise have been.

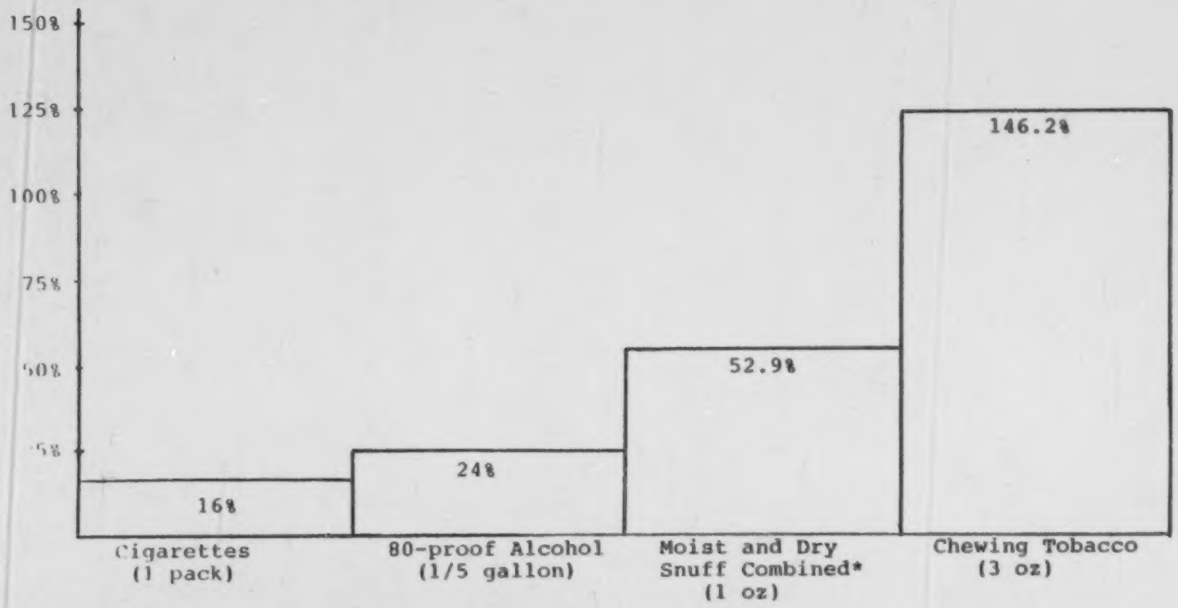
The general argument here is not specific to an excise tax on smokeless tobacco products; it is just as valid with regard to excise taxes on a wide range of products. The initial justification for excise taxation was that it provided a way to tax luxury goods, presumably being consumed by the wealthy. There may have been a period in our history when such a justification had some basis in fact and the economic inefficiencies generated by excise taxes were compensated for by equity considerations. Today, however, it is hard to make the case that federal excise taxes on beer, wine, cigars, cigarettes, and tires are luxury taxes. The low-income worker who enjoys some smokeless tobacco on the job, and has a beer when he gets home in the evening, is almost surely not a rich, luxury-consuming individual who deserves to be singled out by tax system and punished for his consumption choices. Interestingly, the federal excise taxes on furs and jewelry, goods which could still qualify legitimately as luxury goods, were repealed in 1965.

Although the excise taxation of many products violates the norms of efficiency and equity, the proposed excise taxation of snuff and chewing tobacco is particularly offensive in this regard. For example, if House Resolution 3078, which had been introduced by Congresswoman Collins, is enacted, then the federal tax on smokeless tobacco, as a percentage of the pre-tax value of the product, will be substantially higher than the federal excise tax on any other good. Even if the less pernicious House Resolution 3064, introduced by Congressman Tauke, is enacted, the distorting effect with respect to smokeless tobacco production and consumption decisions would still be large relative to the distorting effect of excise taxation on other targeted goods. Comparisons among different products of this economically relevant measure of the distorting impact of excise taxes are presented in Figure 1. In both cases the wedge which would be inserted between the price consumers pay and the price suppliers receive would motivate a significant diversion of resources out of more valued and into less valued productive activities. The excise tax on alcoholic beverages, for instance, is levied at the rate of $10.50 per proof gallon. This translates into a tax of $1.68 for 80-proof liquor in a one-fifth gallon bottle. Similarly, the federal excise tax on cigarettes represents 16 cents of the current retail price of roughly $1.00 per pack. Both of these figures pale in comparison with the excise tax rates currently being considered for chewing tobacco and snuff. As a percentage of pre-tax price, the proposed federal levies on smokeless tobacco can only be described as punitive: they are at such a high level that their purpose cannot be to raise tax revenue, but rather to prevent individuals from purchasing products they would otherwise freely choose to consume.

There is another distortion that would result if any of the smokeless tobacco taxes were adopted. All of the proposals fail to recognize that an ounce of chewing tobacco is not equivalent to an ounce of snuff. As a rough rule of thumb, a 1.2-ounce tin

FIGURE 1. EXCISE TAX: PERCENTAGE CHANGE OVER RETAIL PRICE

(32¢ per ounce tax on smokeless tobacco)



*Because of the many different sizes of snuff, 1 oz is used here for illustrative purposes as a standard size.

of snuff is equivalent to a 3-ounce pouch of chewing tobacco. By imposing the same per ounce excise on chewing tobacco as on snuff, both proposals would tax chewing tobacco a little over twice as much as they would tax snuff on a purchase-equivalent basis. Given the large sizes (relative to the pre-tax price) of the proposed taxes, this difference would significantly distort consumption choices between snuff and chewing tobacco. The after-tax price of snuff would decline noticeably relative to the after-tax price of chewing tobacco, and many who would prefer chewing tobacco at prices which reflect actual production costs would shift to snuff if either of the proposed taxes is enacted. (This point is discussed further in Section V.)

The Incidence of an Excise Tax on Smokeless Tobacco

An excise tax on smokeless tobacco which increased the price consumers would have to pay by the tremendous percentage threatened by either H.R. 3064 or H.R. 3078 would violate to a most unfortunate degree one of the most fundamental standards of tax equity. The one standard of equity which is almost universally accepted by students of public finance, and by the general public, is known as horizontal equity. The standard of horizontal equity requires that two people who have the same income pay the same tax. As with all standards, it cannot be expected that horizontal equity will ever be achieved with perfection. No matter how carefully our tax system is designed, there will always be cases where two individuals face different tax burdens even though their incomes are identical. But the inability to achieve perfection should not give license to ignore such an obviously equitable standard as that required by horizontal equity. But this is exactly what the proposed excise taxes on snuff and chewing tobacco do. They ignore the basic fairness of treating equally those who are in fundamentally equal situations. Those individuals who choose to purchase smokeless tobacco will, everything else equal, suffer a larger tax burden than those who do not. This is the type of inequity and discrimination we should be trying to purge from, not insert into, our tax system.

Turning to another standard of tax equity, that of vertical equity, we do not find nearly the same consensus as we do in the case of horizontal equity. The fact remains, however, that the proposed excise taxation of smokeless tobacco violates almost everyone's concept of vertical equity. By a vertically equitable tax, students of public finance mean a tax which treats people with different income levels fairly with respect to each other. It should be obvious that there will be less agreement as to what constitutes vertical equity than as to what constitutes horizontal equity.

Some people feel that those who earn very large incomes should pay a larger percentage of their income in taxes than those who earn quite low incomes. In other words, it is felt that as income increases, the proportional tax burden should also increase. When the tax structure reflects this view of vertical equity, the tax is said to be progressive. Based on public opinion polls and the statements of politicians, it is clear that most people feel that taxes should be progressive. Some feel taxes should be very progressive, others feel they should be only mildly progressive, but most people favor progressivity. There are a few who reject progressivity as an equity requirement and feel that for a tax to be vertically equitable it should be proportional, i.e., increasing the tax burden on an individual proportional to increases in his or her income. Almost no one, however, would argue that vertical equity requires that the rich pay a smaller percentage of their income in tax than the poor, which is to say that taxes should be regressive. Regressivity violates almost everyone's notion of tax justice.

Yet the proposed excise tax on snuff and chewing tobacco would be extremely regressive. The reason for this is explained by the well documented fact that consumers of smokeless tobacco products are, on average, less wealthy than the remainder of the population. Data on the distribution of male users of smokeless tobacco by household income level are shown in Table 1. (The data are presented in chart form in Figure 2.) It is apparent that the incidence of chewing tobacco and snuff use declines steadily as one goes up the income distribution. For example, just over 25 percent of smokeless tobacco users had annual household incomes in 1984 of less than $15,000, while only 4.7 percent of those males in households with incomes between $40,000 and $49,000 per year purchased these products. Indeed, fully one-half of all smokeless tobacco users had household incomes of less than $25,000 in 1984.

Further evidence that any tax on smokeless tobacco would be regressive is given by the occupational and educational characteristics of males who use chewing tobacco and snuff. (See Tables 2 and 3, and Figure 3.) Only 4.4 percent of purchasers worked in professional jobs, while 16.1 percent were either craftsmen or

TABLE 1

Percentage Male Chewing and Smokeless Tobacco Users by Household Income

Household Income Class	Percent
Less than $15,000	25.3
$15,000 - $24,999	24.6
$25,000 - $29,999	10.9
$30,000 - $34,999	14.7
$35,000 - $39,999	8.3
$40,000 - $49,999	4.7
$50,000 or more	11.5

Source: Mediamark Research Inc., Spring 1985, p. 260.

FIGURE 2. HOUSEHOLD INCOME: SMOKELESS TOBACCO USERS

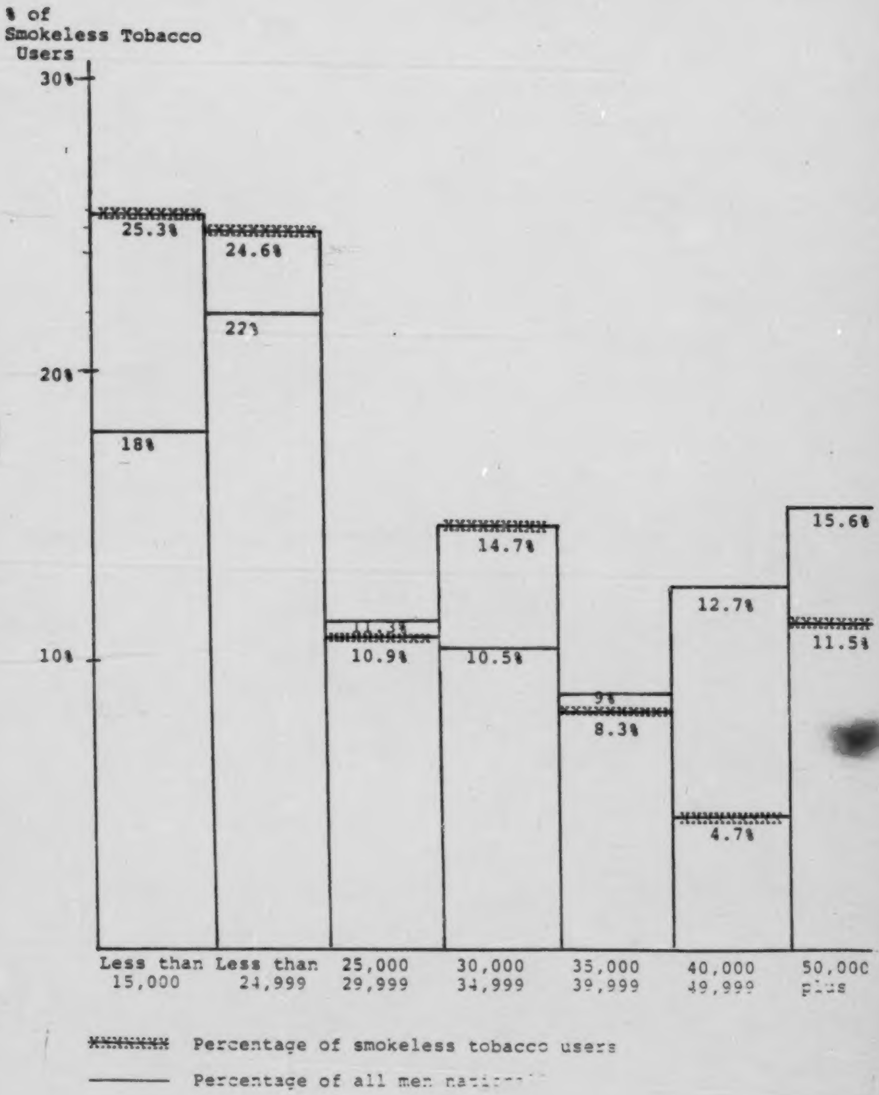


TABLE 2

Percentage Male Chewing and Smokeless Tobacco Users by Occupation

Occupational Category	Percent
Professional	4.4
Executive, Administrative, and Managerial	7.6
Clerical, Sales, and Technical	8.7
Craftsmen and Foremen	16.1
Other Employed	31.0
Not Employed*	32.2

*Includes those males who are unemployed, retired, and not in the labor force.

Source: Mediamark Research Inc., Spring 1985, p. 260.

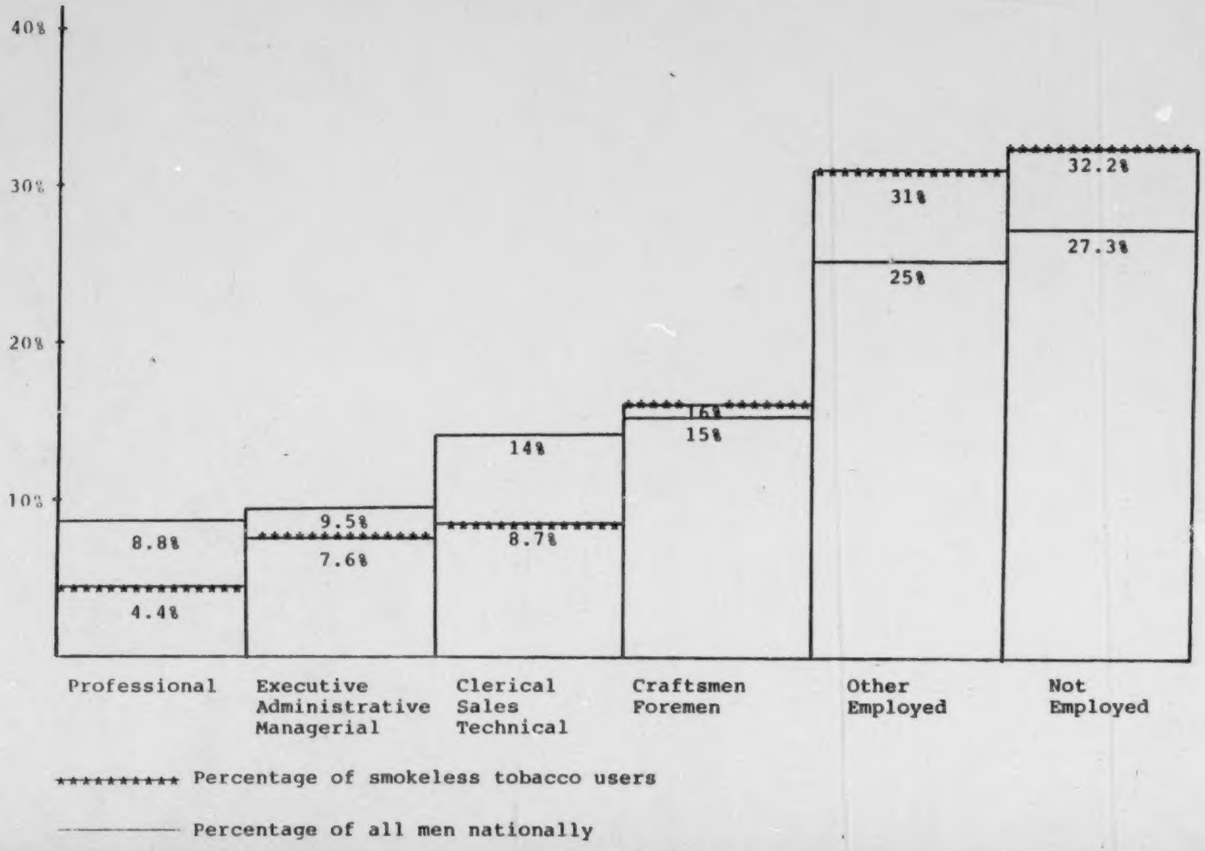
TABLE 3

Percentage Male Chewing and Smokeless Tobacco Users by Education

Educational Level	Percent
Did not graduate high school	35.1
Graduated high school	38.3
Attended college	15.1
Graduated college	11.5

Source: Mediamark Research Inc., Spring 1985, p. 260

FIGURE 3. EMPLOYMENT TYPE



foremen. Indeed, according to a survey conducted by the Home Testing Institute during the months of May-June 1984, 41.2 percent of snuff users held jobs traditionally classified as "blue collar" occupations. Such data are corroborated by the fact that nearly three-fourths of smokeless tobacco users have not received an education beyond the high school level.

In sum, there is no avoiding the unpleasant fact that the proposed excise taxes on smokeless tobacco would impose a larger burden, both absolutely and as a percentage of income, on those with low incomes than on those with high incomes. A tax on smokeless tobacco is a tax on poor people.

III. EARMARKING PROPOSALS

The case against the proposed excise taxes on either equity or efficiency grounds is clear and overwhelming. What then are the arguments put forth by those who are advocating the imposition of an excise tax on snuff and chewing tobacco? There are two basic arguments. One is based on what for many people is an irresistible urge -- the paternalistic desire to guide the behavior of others. The second, which is implied by proposals to earmark tax revenues for Medicare and Medicaid is based on the claim that those who choose to use smokeless tobacco products impose costs on others because they supposedly make excessive use of federally-financed health care programs. In this section we will consider the merits of these arguments.

The Paternalistic Argument

There are those who feel for a variety of reasons that it is not in the best interest of people to use smokeless tobacco products. Of those who profess this concern for others, many feel that an excise tax on snuff and chewing tobacco is justified as a means of discouraging the use of smokeless tobacco.

In considering this paternalistic motivation for a federal excise tax on snuff and chewing tobacco, a general comment is in order at the outset. The tendency to believe that others would be better off if only they benefited from our tastes and preferences is widespread and strong. Fortunately, this is a rather harmless tendency if backed up by no more than our ability to persuade. History is full of atrocities of every kind, however, which point out vividly that paternalism can quickly turn ugly if it is backed up by force, political or otherwise. A major benefit we derive in the U.S. from the checks and balances contained within our constitutional democracy comes from the fact that they make it difficult for people to use government power to impose their values and preferences on others. When working as they should, these checks and balances generate what is in effect a mutual tolerance among our citizens which serve well the interests of us all. Your inability to dictate to others is more than compensated for by the inability of others to dictate to you. So we need to ask ourselves seriously whether or not we want those who feel that the use of smokeless tobacco is an undesirable practice to be able to use the power of the Bureau of Alcohol, Tobacco, and Firearms to dictate to those who feel differently. The growing uneasiness over the degree to which the tax system is already being used to exert political control over our private choices is a significant factor behind the current push for tax reform.

But quite apart from the social ethics of government-sponsored paternalism, there is the question of whether paternalists can really make much progress in achieving their objectives through the use of the tax code. Consider, for example, what the effects of increasing the price of smokeless tobacco products through an excise tax would likely be. One thing is sure. Demand curves are downward sloping, and if the price of any product increases, everything else equal, then less of that product will be demanded. But this fact still leaves some interesting questions unanswered. For example, exactly how sensitive is the quantity demanded to changes in price, or how price elastic is demand? As far as we know, there have been no detailed studies of the price elasticity of the demand for smokeless tobacco products, so we cannot say with confidence whether the proposed excise taxes would reduce the consumption of snuff and chewing tobacco a little or a lot. To the extent that studies of the price elasticity of demand for cigarettes are any guide, the quantity of smokeless tobacco products consumed will not be very sensitive to increases in price. There is no doubt, however, that a price increase will result in some reduction in the quantity demanded.

In considering then whether or not to impose an excise on smokeless tobacco, one should ask, does it make sense to give the government more control over our private choices when the predictable consequences of doing so will be to prompt the paternalists among us to demand still further intrusions? Those who do not believe that we have already passed the acceptable limit to such practices are not likely to ever recognize such a limit.

Earmarking

Some of the legislative proposals are reported to contain provisions for earmarking part or all of the federal excise tax revenues to fund public health care programs. Such proposals are normally justified by the unsubstantiated argument that users of smokeless tobacco place a disproportionate burden on such programs as Medicare and Medicaid. The idea is to earmark some or all of the revenues raised for Medicare and Medicaid, thus requiring those who alledgedly make the most use of these programs to pay a larger share of the financial burden.

The immediate problem with this argument is that there is a controversy about the health risks associated with many products. If we were serious about financing federal medical care programs by imposing excise taxes on any product which someone is willing to assert causes health problems, then why single out smokeless tobacco? Eggs, salt, red meat, soft drinks with sugar, soft drinks without sugar, coffee, tea, chocolate, power mowers, ladders, high decibel speakers, bicycles, motorcycles, skiing equipment, and hair curling chemicals are just a few of the large number of products which some claim cause sickness and injury, and are not now subject to federal excise taxation. It is therefore difficult to understand how anyone could think it fair to require the users of chewing tobacco and snuff to pay a special charge for the Medicare program while not imposing such a requirement on those who seek enjoyment from downhill skiing, or chocolate binges, or any one of a hundred other activities.

But quite apart from the question of whether the consumption of chewing tobacco or candy bars leads to any increased demand on the Medicare budget, it is a highly questionable proposition that people should be charged on the basis of a user fee for federal medical care programs. The laudable ideal behind publicly financed medical service is that proper medical treatment should be available to everyone in our society on the basis of their need for care, not on the basis of the payments they make. Political supporters of Medicare and Medicaid are justified in their claim that it is the imperatives of compassion and justice which provide the rationale for these programs. But what is more at variance with this humanitarian rationale than the suggestion that low-income consumers of smokeless tobacco should face a special charge for their medical care while high-income citizens who do not consume smokeless tobacco should not?

Federally subsidized medical care is by its very nature a transfer program. It has always been understood that it would transfer income to those who made above average use of medical services from those who made below average use of medical services. The fact that it was thought desirable to make such transfers has justified the significant federal involvement in our health-care industry. If we have decided that these transfers are no longer justified and people should pay for the medical care they receive, we should be honest about it and discard the rhetoric about concern and compassion. We should also recognize that there are much better ways to improve the connection between the amount people pay and the medical care they receive than through the imposition of a clumsy excise tax on smokeless tobacco. It would be far better, for example, simply to return medical care decisions back to the market place. Not only would people be required to pay for the care they receive, but this care would be provided much more efficiently.

But, of course, we have not decided that the transfers which are the very essence of federally subsidized medical care are no longer justified. No one is seriously proposing that medical resources should be allocated entirely through the forces of the private market. There is a good reason for this. We as a society do not want to assume the mentality of a storekeeper, making sure that no one gets something they did not pay for directly, where proper medical care is concerned. And, because of this attitude toward medical care, the suggestion that smokeless tobacco users should be subject to a special assessment for Medicare and Medicaid is completely at variance with the sense of justice upon which these programs are based in the first place.

Private Costs Versus Social Costs

The issue of governmental interference in the private activities of its citizens is extremely controversial, as is the question of how government should go about regulating individual behavior if it decides to do so. Generally, in instances where government action may be deemed necessary, the decision to interfere with private commerce and the rights of private citizens has been made with extreme caution. Such action may be taken to remedy a situation when the private market fails to produce an appropriate or desired outcome, resulting in social costs to society which can only be rectified by government intervention. For example, the costs to society of air and water pollution were deemed sufficiently high to precipitate passage of the Clean Air Act of 1970 and the Clean Water Act of 1972.

In the case of pollution, private businesses did not have sufficient incentives to reduce air pollutants or refrain from emitting effluents into our waterways. Therefore, Congress imposed sanctions against an activity it determined was harmful to the public (i.e., pollution). Government action was taken to ensure that private businesses would take into account in their production process not only the private costs of inputs, such as capital and labor, but also the ssts of pollution were significant and that the private market, by itself, would not create the incentives for businesses to reduce pollution. This so-called "market failure" and the presence of high social costs precipitated government intervention. On the other hand, in the absence of private market failure and significant social costs, government action is not only unwarranted but can actually be detrimental to the efficient operation of our economy.

It is the contention of some that benefits would result from the smokeless tobacco legislation. There is some question, however, whether the proponents of the bills have not confused private costs with social costs in their efforts to promote adoption of the laws. Before a comparison of costs and benefits of the bills can be considered, it is important that the distinction between private costs and social costs is understood.

The Congress must first determine whether there are social costs associated with the use of smokeless tobacco, and then, if social costs are positive, it should weigh the costs and benefits of its action. The following example illustrates what we mean by "social cost".

Consider a utility which, prior to government regulation, generates electricity by burning coal. Soot, a by-product of the production of the electricity, escapes from the utility's smokestacks. In order to generate the electricity, the utility must pay directly for capital and labor inputs. Air pollution control equipment which would remove the soot is costly and not essential to production and, therefore, the utility has no incentive to install it. As a result, the soot blows downwind and soils laundry drying on the line, cars, homes, etc., imposing clean-up costs on people living in the area. The total cost of the production of electricity is actually the cost of cleaning the private property besmirched by the soot (the social cost) as well as the private costs (the resources such as capital and labor). Because the utility does not account for social costs in its production process, the price that consumers pay for the electricity does not reflect the total cost of production.

In this example, the costs created by the production of the soot are uncompensated costs because they are not paid by the utility or its customers, but are paid by the private individuals affected by the soot. This uncompensated cost, often called an externality, represents a social cost. There are various ways to force the utility to take these social costs into account. For example, the government could actually prohibit the emission of soot from the smokestacks, thus requiring it to totally eliminate the production of soot. Alternatively, government regulations which mandate the installation of air pollution control equipment could be promulgated to minimize soot production, again eliminating the uncompensated or social costs. In both instances, government regulation of the soot production has forced the utility to internalize the social costs resulting from its behavior and, by so doing, has increased economic efficiency. The critical point in this example is that the government action was precipitated by the presence of social costs in the production of electricity. If there had not been social costs involved, there would have been no reason for the government's intervention.

In discussing whether or not to earmark smokeless tobacco taxes, it is necessary to distinguish between the private costs of using these products and the social costs, if any. In the absence of significant social costs, government intervention is totally unwarranted.

Some proponents of such legislation always suggest that individuals who use products like smokeless tobacco suffer health consequences that cause them to be absent from work more often than non-users and that the loss of production from these workers is a significant social cost of smokeless tobacco consumption. Advocates contend that a law restricting consumption would have the salutary effect of reducing employee absences and, therefore, would provide significant benefits to the economy. In other words, it has been alleged that there are social costs associated with smokeless tobacco and, hence, social benefits to be derived from reducing its use. Closer examination of this assertion indicates that a common error, confusion of social and private costs, has been made.

As stated above, a social cost exists when one individual is made worse off by the action of another individual and no compensation is made by the offender to offset this condition. The example cited previously concerning the soot from the electric utility is an example of a social cost. Even if it were true that individuals who use chewing tobacco and snuff are absent from work more often than nonusers and that these additional absences are caused by the products (note that there is no factual evidence supporting these two assertions), these production losses would measure the private costs to the individual user of smokeless tobacco and would not represent a social cost. The costs of absences are borne entirely by the individual in the form of lower wages, fewer promotions, and so on.

Another argument that has been made by advocates concerns the costs of increased expenditures by society for treatment of illnesses allegedly attributable to smokeless tobacco. Again, this is another case of mistaking private costs for social costs. Since the evaluation of this argument follows that of the earlier comments, it can be dispatched with less discussion.

In the case of individuals who purchase health insurance, the insurer assumes some of the possible risk that some people may have higher health costs than others, and this fact, if it is significant, will be reflected in the price of insurance premiums. These adjustments reflect the insurance carrier's judgment of the increased risk of health impairment for any activity, including the use of smokeless tobacco. This cost is internalized by the private insurer, paid by the insuree, and no social cost exists.

In this discussion, we have attempted to clarify the distinction between private and social costs of smokeless tobacco. As we have seen, given the hypothetical that use of these products results in costs, these are costs which are borne by the individual, not by society. It should also be mentioned that attempts to estimate the "social" costs of smokeless tobacco not only confuse private and social costs, but also result in double-counting. When alleged private costs are already borne by the individual, to also count these as "social" costs essentially counts these costs twice. Cost-benefit analyses of many activities often make this error and, as a result, drastically overstate costs.

IV. FISCAL FEDERALISM

There are currently 20 states which impose an excise tax on smokeless tobacco. On the basis of efficiency and fairness these excise taxes are subject to the same criticism as are those being proposed at the federal level. However, if excise taxes on smokeless tobacco are going to be imposed, there is reason for believing it is better to confine them to the state level.

The federal government has moved in recent years to reduce the aid it is giving the states. Whether this is a good idea or not is not the concern here. But if such a reduction is occurring, it follows that the federal government should also avoid encroaching on tax bases which provide sources of state tax revenue. Enacting an excise tax at the federal level, particularly of the magnitudes being proposed, would serve to crowd out the states' ability to raise revenue from the same source. The National Governors Association and the National Conference of the State Legislatures have gone on record to say that excise taxes should be reserved as a source of state revenue (letter by Donald Shea, Washington Post, August 27, 1985, p. A14).

The data shown in Table 4 suggest that excise taxes on smokeless tobacco products generate a nontrivial amount of revenue for the states that impose such levies. In 1984, for example, the states collected over $47 million from taxes on chewing tobacco, snuff, cigars, and smoking tobacco (separate

Table 4

Net State Revenue from Other Tobacco Taxes*
(Fiscal Year Ending June 30, 1983)

State	Net Collections	Percentage of Total Tobacco Taxes
Alabama	$ 1,538,318	2.3
Arizona	521,037	1.2
Arkansas	3,093,659	4.9
Hawaii	1,983,631	10.0
Idaho	1,253,353	11.7
Iowa	1,158,269	1.9
Kansas	1,173,151	2.6
Minnesota	3,034,778	3.6
Mississippi	3,641,095	10.6
Montana	659,118	5.0
Nevada	833,584	4.6
North Dakota	324,486	2.3
Oklahoma	3,286,014	4.2
South Carolina	2,012,163	6.5
Tennessee	2,431,203	3.1
Texas	9,819,013	2.8
Utah	668,096	4.9
Vermont	457,912	4.4
Washington	5,229,449	5.2
Wisconsin	3,940,190	3.0
Total	$47,058,519	3.5

*Includes revenues from taxes on chewing tobacco, snuff, cigars, and smoking tobacco.

Source: Tobacco Institute, The Tax Burden on Tobacco, January 1985, p. 60.

figures for smokeless tobacco were not available). Moreover, these revenues accounted for up to 10 percent of total tobacco taxes collected in some of the states (Hawaii, Idaho, and Mississippi), and never less than 1.2 percent of such revenues.

It is obvious that imposing any federal levy on top of an existing state tax will reduce the tax revenue generated at that level. This result holds even more strongly for the punitive federal excise tax rates currently under discussion. Adding a 16- or 32-cent per ounce federal excise to the tax rates now imposed by these 20 states will surely have a substantial adverse impact on the revenues listed in Table 4. This will force the states to seek other revenue sources for financing essential public services, adding to the fiscal pressures threatened by other federal tax proposals such as the elimination of the income tax deduction for state and local taxes.

The states which collect substantial tax revenues from smokeless tobacco are able to do so precisely because of the absence of a federal levy on these products. It is clear that state tax rates on the order of 40 to 50 percent of wholesale price (Hawaii, Idaho, and Washington) could not be sustained with the addition of federal taxes of the magnitudes being considered. This is just another illustration of the punitive nature of the proposed excise tax on smokeless tobacco: it would either force the states to lower their tax rates, drive the industry into bankruptcy, or both.

There is another reason for wanting to see a tax like an excise on smokeless tobacco confined to the state level. To repeat, such a tax has little to recommend it and in an ideal world would not be enacted at any level. However, if such a tax is going to be enacted, its unfortunate consequences will be more likely moderated if enacted at the state level rather than the federal level. If any particular state enacted an excise tax with rates as high as those being proposed on smokeless tobacco at the federal level, little revenue could be expected to be raised as a result. In the case of state excise taxes on smokeless tobacco, high tax rates in one state would motivate consumers to purchase their tobacco from suppliers in other states where the tax is lower. It is the possibility of this interstate tax competition which prevents taxes at the state level from becoming excessive.

V. TAX INSTRUMENTS AND TAX POLICY

Despite the overwhelming evidence that a federal tax on chewing tobacco and snuff would be highly inequitable, the Congress may nevertheless choose to impose such a levy. If it does so, it is important to consider what type of tax instrument would best achieve the policy goals set out in the proposed legislation. Both economic theory and the precedents established by the states which tax these products suggest that different tax rates should be applied to chewing tobacco and snuff.

Simply put, a uniform excise tax on smokeless tobacco would impose a significantly higher effective tax rate on users of chewing tobacco than on users of snuff. This is because the two products are typically sold in packages of different weight. Chewing tobacco, for example, is normally sold in a 3-ounce package. The equivalent for snuff is a 1.2-ounce tin. Under proposed legislation which imposes an excise of 16 cents per ounce or part thereof, chewing tobacco users would therefore be forced to pay up to 48 cents per package in federal taxes, whereas snuff users would only pay about 32 cents in taxes. The corresponding figures for a 32 cents per ounce (or part thereof) excise are 96 cents and 64 cents, respectively. These taxes range from 72.4 percent to 138.8 percent of the manufacturers' list price for chewing tobacco, and from 64.0 percent to 128.0 percent of the manufacturers' list price for snuff in the appropriate units. An excise tax thus creates an additional inequity by imposing differential burdens on users of smokeless tobacco.

The disproportionate impact of a flat excise tax on smokeless tobacco products can be minimized by applying a lower tax rate to chewing tobacco than to snuff. There is substantial precedent for such a "classified tax" approach. (State governments which impose taxes on chewing tobacco and snuff have solved the problem in a different way. Seventeen of the 20 states that tax smokeless tobacco express the tax as a percentage of either manufacturers', wholesale, or retail price. Use of an ad valorem tax rather than an excise means that smokeless tobacco users face the same effective tax rate regardless of the weights in which the products are purchased. This strategy would be difficult to implement at the federal level, however, because the BATF does not have the resources for collecting ad valorem taxes. See Table 5.) The federal excise tax on alcohol, for example, is levied in terms of "proof gallons" in order to tax products with different alcoholic content at similar rates. Moreover, state excise taxes on cigars are often classified on the basis of type and/or weight.

To see how such a classified excise tax on smokeless tobacco would operate, consider updating the tax on manufactured tobacco abolished in 1965. As mentioned earlier, the 1965 tax was set at 10 cents per pound. To apply the same effective tax rate in 1985 to moist snuff, the tax rate should be set at 24.0 cents per pound. The purchase-equivalent tax for loose leaf chewing tobacco would be lower, however. For the total taxes on a 3-ounce pouch to represent the same percentage of list price as for a 1.2-ounce tin of snuff, the tax rate would be set at 8 cents per pound. Classifying the tax in this way achieves tax parity between moist snuff and chewing tobacco. However, this is just an example of how tax parity could be achieved. Other classification schemes might be desirable.

In sum, a classified excise tax is to be preferred to a uniform tax because it would impose the same effective tax rate on chewing tobacco and snuff users. If the Congress chooses to impose a tax on smokeless tobacco, it is highly recommended that the tax per unit weight be set at a lower level for chewing tobacco than for snuff.

It should also be stressed that the calculations in this section are illustrative and not suggestive. First best is no tax.

TABLE 5

State Tax Rates on Chewing Tobacco and Snuff

State	Tax Rate
Alabama	Chewing Tobacco: 3/4 cents of each ounce or fraction thereof. Snuff: 5/8 ounces or less, 1/2 cent; 5/8 ounces - 1 5/8 ounce, 1 cent; 1 5/8 ounces - 1 1/2 ounces, 2 cents; 2 1/2 ounces - 3 ounces, 2 1/2 cents; 3 ounces - 5 ounces (cans, packages, gullets), 3 cents; 3 ounces - 5 ounces (glasses, tumblers, bottles), 3 1/2 cents; 5 ounces - 6 ounces, 4 cents; Over 6 ounces, 1 cent for each ounce or fraction thereof.
Arizona	Chewing Tobacco and Snuff: 2 cents per ounce or major fraction thereof. Plug Tobacco: 1/2 cent per ounce or fraction thereof.
Arkansas	16% of manufacturers' invoice price.
Hawaii	40% of wholesale price.
Idaho	35% of wholesale price.
Iowa	10% of wholesale price.
Kansas	10% of original invoice price from manufacturer to wholesaler.
Minnesota	20% of wholesale price.
Mississippi	9/16 cents for each 5 cents or fraction thereof of retail price.
Montana	12.5% of wholesale price.
Nevada	30% of wholesale price.
North Dakota	11% of wholesale price.

TABLE 5

State Tax Rates on Chewing Tobacco and Snuff (Continued)

State	Tax Rate
Oklahoma	Chewing Tobacco: 30% of factory list price.
South Carolina	5% of manufacturers' price.
Tennessee	6% of wholesale price.
Texas	25% of factory list price exclusive of any trade discount, special discount or deal.
Utah	25% of manufacturers' price.
Vermont	20% of distributors' price.
Washington	48.15% of wholesale price.
Wisconsin	20% of wholesale price.

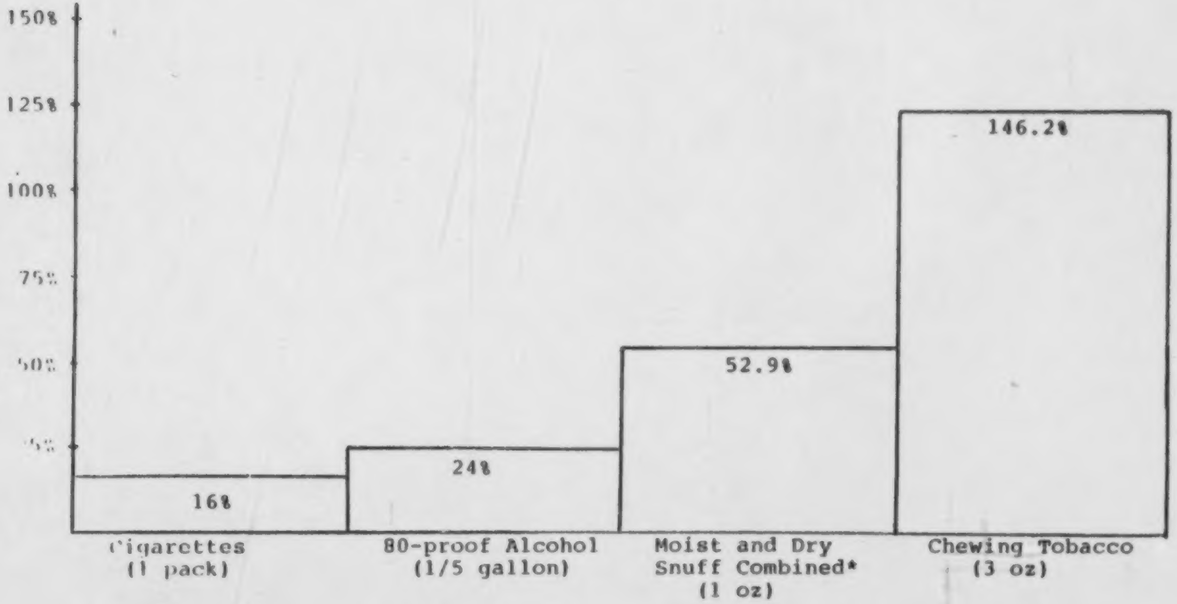
Source: Tobacco Institute, The Tax Burden on Tobacco, January 1985, p. 61.

VI. CONCLUSION

No matter what criteria one chooses to use for judging the worth of a federal excise tax on smokeless tobacco, one comes to the conclusion that such a tax is unwarranted. Such a tax would generate economic inefficiencies, it would grossly violate any acceptable standard of horizontal and vertical tax equity, and it would fail to achieve the dubious objective of a user fee for medical services.

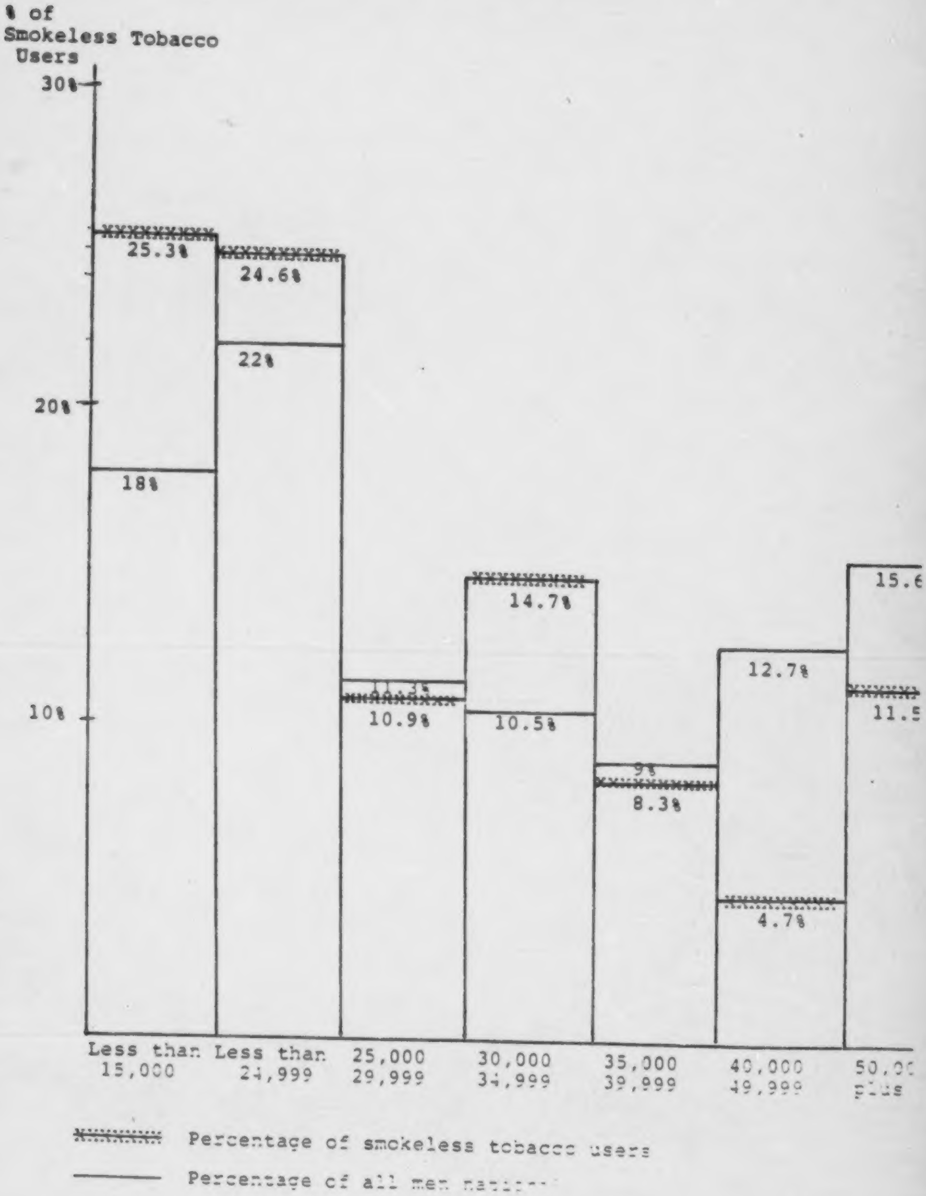
The reason tax reform is now firmly on the political agenda is that over the years our federal tax system has become riddled with provisions which generate inefficiencies, discriminate unjustly against those who are unorganized politically, and fail to accomplish the objectives they were supposed to, provisions which in this regard are unfortunately like the proposed excise tax on snuff and chewing tobacco. It is ironic, and not a little disheartening, to see such proposals being made at a time when it appears that there is a real hope that tax reform will begin purging our federal tax system of such senseless provisions. A proposal such as those urging the imposition of an excise tax on smokeless tobacco could have never gotten through Congress on the basis of its merits. Let's hope that the time has come when it cannot get through Congress on the basis of political expediency. The country, the economy, and our sense of justice and fairplay deserve better.

FIGURE 1. EXCISE TAX: PERCENTAGE CHANGE OVER RETAIL PRICE
(32¢ per ounce tax on smokeless tobacco)



*Because of the many different sizes of snuff, 1 oz is used here for illustrative purposes as a standard size.

FIGURE 2. HOUSEHOLD INCOME: SMOKELESS TOBACCO USERS



STATEMENT OF MAX LOYD, PH.D., PROFESSOR OF AGRICULTURAL ECONOMICS AND RURAL SOCIOLOGY, CLEMSON UNIVERSITY, CLEMSON, SC

Dr. LOYD. Thank you, sir. Mr. Chairman and members of the subcommittee, I am Max I. Loyd, professor of agricultural economics at Clemson University, and I thank you for the opportunity to present testimony on the cigarette excise taxes. Since by law the Federal excise tax is scheduled to revert back to 8 cents on October 1, I will refer to any tax above 8 cents as a tax increase. I will make two major points. First, excise taxes are economically inefficient. Second, the temporary doubling of the Federal cigarette excise tax along with other economic conditions has placed tobacco farmers in a near-disastrous situation. A couple of subsidiary points that I won't really pursue: One is that cigarette taxes are a regressive tax as has been pointed out several times today. To pursue the first point, economists have long recognized the economic inefficiency of excise taxes, compared to broader based taxes, and no doubt you have heard or read about that particular principle. But briefly, excise taxes are inefficient because they don't allow the market to reflect the value of resources used in producing the taxed item versus other goods and services; and this means that consumers, in adjusting for the tax, give up more benefits than the Government can provide by using the tax revenue. So, the excise tax results in a net economic loss. Now, the opposing argument, which I will mention, is that smokers are subsidized by nonsmokers, as we have heard a great deal about today in various kinds of health care costs. Now, I do question the cost data. These comments are in my paper. I won't pursue them in depth at this point.

Senator CHAFEE. Did you give us a full paper? I have the summary, but I can't find the full paper.

Dr. LOYD. Yes; I did. I have other copies if someone needs one. Those points are mentioned, and so I won't go into more depth, except to say that I do question them. And given the fact that around the $7 billion or more, and probably more depending on what the States do if the Federal excise tax does sunset, that $7 billion or more will be collected one way or another. And of course, it will be well above $7 billion because some of the States will increase their taxes even if the 16-cent Federal excise tax is extended. But anyway, without the 16 cents, it appears to me that the figures don't justify a Federal excise tax in excess of 8 cents a pack. Again, I have done some more homework since I prepared that written testimony, and I am sure I will have the opportunity to respond to some questions, and I will welcome that opportunity, since that is a rather strong statement to make for one who calls himself a scientist, considering the esteemed company that I am with. Now, finally, the other point, we should also consider the impact of excise taxes on tobacco producers. Now, in 1982, when the no-net cost legislation was being negotiated, farmers really were not aware of the fact that—in fact, there was not much talk about the increase in the excise tax at that point. And they knew that something had to be done to respond to world economic conditions—the increasing value of the dollar, et cetera—and so, they were fairly optimistic that this no-net cost program would eventually work out. You know, they weren't at all happy, and they realized that other producers of agricultural commodities did not have to bear such a burden. But subsequent events, including the temporary doubling of the Federal excise tax that resulted in no-net cost tobacco stocks of near crisis proportions. By conservative estimates which are detailed in the written testimony, the 1983 Federal excise tax increase has caused a reduction in purchases of U.S. tobacco: About 128 million pounds of Flue-cured and about 110 million pounds of burley. Of course, that along with the other economic conditions I mentioned has resulted in a near disastrous situation for the no-net-cost loan stocks. Continuation of the 16 cents per pack Federal excise tax would complicate the problem. And with that I will close. Thank you, sir.

Senator **Chafee**. Thank you very much, Dr. Loyd.

Senator **Bradley**. Mr. Chairman, does he have a full statement?

Senator **Chafee**. Yes; I just got a copy of it, and we will get one to you. Dr. Warner.

[The prepared written statement of Dr. Loyd follows:]

TESTIMONY OF
MAX I. LOYD, PROFESSOR, CLEMSON UNIVERSITY, S.C.
TO
THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT,
OF THE SENATE FINANCE COMMITTEE
ON
THE EXPIRING CIGARETTE EXCISE TAX
September 10, 1985

Mr. Chairman and members of the Sub-Committee, I am Max I. Loyd, Professor of Agricultural Economics at Clemson University. Thank you for the opportunity to present comments on cigarette excise taxes.

Economists have long recognized the economic inefficiency of excise taxes, versus broader based taxes, as a means of raising revenue. However, for decades, cigarette excise taxes have been a favorite vehicle for producing revenue, by the Federal and State governments in the U.S. Cigarettes are a natural target for excise taxes. The retail price elasticity of demand for cigarettes is about -.5, so a 1 percent tax induced price increase only reduces consumption by about .5 percent. (Doubling the Federal excise tax in 1983 resulted in an increase in revenue of about 90 percent). Further, cigarette smokers only amount to about one-third of eligible voters.

No doubt most of you have heard or read the arguments concerning the economic inefficiency of excise taxes as revenue producers. But I'll briefly review the relationships involved in non-technical terms. Simply stated, the problem with an excise tax is that it changes the price ratios between the taxed item versus other goods. The changed price ratios do not reflect the relative costs of producing the taxed item versus other goods. The result is that benefits (or "utility"), given up by consumers in making adjustments to the excise tax, are greater than the benefits that can be provided by the government through using the excise tax revenue. The end result is a net economic loss due to the excise tax. I should point out that economists disagree on some of the "finer points" involved, such as aggregating and applying the effects, but are near unanimous in agreement on the basic principle.

An opposing argument voiced by some is that smokers are subsidized by non-smokers through medical insurance premiums and through State and Federal funds used for health care. If one could accept the cost figures claimed by some groups, then perhaps a cigarette excise tax could be justified, economically. The strident nature of these claims often implies more emotion than objectivity. The number of smoking related ailments are based on generalities, but still appear to be inflated even if you accept the generalities. Further, even if you accept the numbers, the cost figures claimed appear to ignore the cost of alleged "smoking ailments" that are born by smokers themselves.

Other testimony will pursue the smoking-health issue in more depth. It will be up to you as committee members to decide whether alleged smoking related health care costs to non-smokers, justifies further interference with the market via an increased Federal excise tax. At best; more sound, scientific research is needed on this subject.

State and Municipal cigarette excise taxes amount to about $4.5 billion annually. These excise taxes will increase overall -- with or without continuation of the 16 cent per pack Federal tax -- but the increase in state taxes will obviously be greater if the Federal tax reverts to 8 cents per pack as scheduled. The various claims concerning smoking related health care costs do not appear convincing enough to justify a Federal cigarette excise tax of 16 cents per pack, in addition to the existing and projected state and municipal excise taxes.

By law, the Federal cigarette excise tax reverts to 8 cents per pack on October 1, 1985. As the committee well knows, any excise tax above 8 cents per pack is a tax increase. So I'll use the term "increase" to apply to any Federal excise tax above 8 cents. Whatever the arguments offered for an increase in the Federal excise tax, any such increase is primarily a revenue measure. That is, a convenient way of increasing revenue while appearing to oppose tax increases. One might question whether this committee would even bother with increasing the cigarette excise tax (i.e., back to the

16 cents per pack level), if the increase only resulted in perhaps $2.4 million annually in additional revenue instead of the expected amount of nearly $2.4 billion.

Another serious problem with cigarette excise taxes is their regressive nature. Low income consumers are taxed at a higher percentage of income than high income consumers. This is so obvious it hardly needs comment, but should be considered in evaluating such taxes.

Overall, the greatest direct impact from an increase in the cigarette excise tax would fall on smokers, but we should also consider the impact on tobacco producers. In 1982, most producers of quota tobacco were fairly optimistic about prospects under the no-net-cost legislation -- even though producers of other farm products were not required to shoulder such a burden. But subsequent events, including the temporary doubling of the Federal cigarette excise in 1983, have resulted in no-net-cost tobacco loan stocks of crisis proportions. I refer here to flue-cured and burley tobacco which account for practically all of the U.S. quota tobacco used in cigarettes.

A recent study by Daniel A. Sumner and Michael K. Wohlgenaut at N.C. State University estimated that the 1983 Federal excise tax increase reduced the amount of U.S. tobacco used by domestic cigarette manufacturers by 4.5 to 4.7 percent. If we use the lower figure, this would equate to annual reductions of about 21.5 million pounds for U.S. flue-cured and about 20 million pounds for burley. For the 33 month period of the tax increase the total reduction in use would amount to about 59 million pounds of flue-cured and 55 million pounds burley. This doesn't sound large compared to total CCC loan stocks, but there's more. Cigarette manufacturers normally maintain stocks so as to age tobaccos by an average of about 2.75 years. This would amount to a further reduction in purchases, since 1982, of about 59 million pounds of flue-cured and 55 million pounds of burley, (for a total of around 128 million pounds of flue-cured and 110 million pounds of burley). The effects of the excise tax increase combined with other economic forces have actually caused a much greater decrease in company stocks.

Since 1982 manufacturers have reduced flue-cured stocks by more than 360 million pounds and have reduced burley stocks by about 180 million pounds. This has resulted in accumulated CCC loan stocks of about 794 million pounds of flue-cured and about 525 million pounds of burley, as of August 1, 1985.

It is also obvious that the prospect of a continued 16 cents per pack Federal excise tax, and the possibility of an even higher tax, have affected company purchases on this year's flue-cured markets. Granted, the dramatic increase in the value of the U.S. dollar and the (partly related) increase in foreign production of tobacco have had a greater impact on the demand for U.S. tobacco than has the increased excise tax. Overall, the result has been devastating. Growers are faced with almost certain further income reduction through tobacco program changes or further increases in no-net-cost assessments. Their already desperate situation will become worse before the problems are solved. As pointed out above, continuation of the temporary 1983 Federal excise tax increase will add considerably to their burden.

This committee should seriously consider the fundamental economic inefficiency and inequity of excise taxes in general, versus the validity of alleged smoking related health care costs to non-smokers. The committee should also consider the impact of the excise tax on tobacco producers and on employment in the tobacco industry. Given the State and Municipal excise taxes that will be collected, amounting to around 15.4 cents per pack or more; the available evidence does not appear to justify a Federal cigarette excise tax of more than 8 cents per pack.

STATEMENT OF KENNETH E. WARNER, PH.D., PROFESSOR AND CHAIRMAN, DEPARTMENT OF HEALTH PLANNING AND ADMINISTRATION, SCHOOL OF PUBLIC HEALTH, UNIVERSITY OF MICHIGAN, ANN ARBOR, MI

Dr. **Warner**. Thank you, Mr. Chairman and members of the subcommittee. My name is Kenneth Warner. I am an economist and professor and chairman of the Department of Health Planning and Administration at the University of Michigan School of Public Health. In the past 4 years, I have published more than a dozen scholarly articles relating to the economic and health implications of the cigarette excise tax. As this hearing has demonstrated, the issues surrounding the excise tax are both numerous and complex. In my oral testimony, I will discuss only two of these: The cigarette consumption and health implications of the tax, and the issue of regressivity. During the question and answer session, I would be happy to answer, or at least address, any of the other economic issues that have been raised during this hearing. My conclusions about the consumption and health implications of the scheduled decrease are based on a paper I prepared for the Conference on Tobacco Excise Taxes held by Harvard's Institute for the Study of Smoking Behavior and Policy this past April. I have submitted a copy of that paper with my written testimony. The proceedings have just been published. I believe that Senator Chafee has a copy of them. I request that the entire proceedings of that conference be placed in the record of this hearing as well. My analysis derives from the——

Senator **Chafee**. We will take a look at that. I don't know how big they are.

Dr. **Warner**. Right here, Senator Chafee.

Senator **Chafee**. All right. I will take a look at it. It will get distribution.

Dr. **Warner**. Thank you, sir. My analysis derives from research on how cigarette consumption is affected by price changes, both for adults and teenagers. Using this research, I estimate that if the tax falls back to 8 cents per pack, up to 2 million Americans will be induced to initiate or continue smoking habits when, absent the decrease, they would not have started or would have quit. Of particular importance, as we have heard here, up to half a million teenagers, or 1 million young people aged 12 to 25, will be included in this group of Americans encouraged to smoke by the tax decrease. If one of four of these tax-induced smokers ultimately dies from the smoking habit, which reflects a conservative estimate of the current rate of smoking-related deaths, the halving of the tax will be responsible for causing as many as 500,000 Americans to die prematurely. If, instead of permitting the sunset provision to take effect, Congress were to double the tax to 32 cents, as both of the Senators have proposed, almost 2 million young people would quit or not start smoking, and up to an estimated 3.5 million Americans in total would fall into this category. Doubling the tax could prevent over 850,000 avoidable smoking-related deaths. A doubling of the tax, as has been noted, would simply restore the real value of the tax, its value adjusted for inflation, to what it was when the tax was raised at 8 cents in 1951. My estimates are based on several assumptions discussed in the Harvard conference paper. One of the most important of these is that any tax change will be passed on fully to consumers. Some observers believe, however, that only a portion of an 8-cent decrease would be passed on to consumers. That is, the retail price would not fall by the full 8 cents. If this occurs, my estimates of the numbers of people induced to smoke would have to be reduced accordingly. The tax change that is not passed on to consumers will represent a direct transfer of revenues from the U.S. Treasury to the tobacco industry. Now, I will turn briefly to the issue of regressivity. While cigarette taxes may be somewhat regressive in the aggregate, this is not the issue before this subcommittee. The question here is whether halving the Federal tax will significantly reduce regressivity. For two reasons, I conclude that it will not. One is that halving the tax will save the pack-a-day smoker $29. For a low-income individual with an income of $10,000, this amounts to just three-tenths of 1 percent of income. For an individual with a $40,000 income, it represents just under one-tenth of 1 percent. Clearly, this small difference has no practical effect on the regressivity of the U.S. tax structure.

My second concern is that the technical definition of regressivity fails to take into account the effects of taxes on smoking behavior. Research in both Great Britain and our own country indicates that low income individuals are more responsive to cigarette price changes than are high income people, as would be expected. It follows that the scheduled tax decrease will encourage relatively more low income individuals to start smoking or to continue smoking. When Senator Durenberger earlier in the proceedings referred to the increasing rate of smoking among blue-collar workers, I was particularly sensitive to this issue. It can certainly be predicted that blue-collar workers' rates of smoking will pick up more than white-collar workers if this tax rate is allowed to fall to 8 cents. The additional costs of smoking that these individuals will incur over their lifetimes including simply the additional taxes they will pay dramatically outweigh the modest savings they will realize from the lower tax. Further discussion of the regressivity issues, by the way, is included in a brief paper by Prof. Jeffrey Harris, a physician and economist at Massachusetts Institute of Technology that is found in the proceedings of the Harvard conference. While this subcommittee focuses on matters of tax policy, I urge you to recognize, as Senators Chafee and Bradley obviously have, that your decision represents a significant public health policy recommendation, whether you would have that or not. A tax decrease will encourage hundreds of thousands of Americans to smoke. The decision of Congress on this issue is quite literally a matter of life and death. I thank you for the opportunity to present this testimony.

Senator CHAFEE. Thank you very much, Dr. Warner. You certainly have done a lot of work in this area. Dr. Scott? We welcome you, from the State of Rhode Island.

[The prepared written statement of Dr. Warner follows:]

STATEMENT OF KENNETH E. WARNER, PH.D., PROFESSOR AND CHAIRMAN, DEPARTMENT OF HEALTH PLANNING AND ADMINISTRATION, SCHOOL OF PUBLIC HEALTH, UNIVERSITY OF MICHIGAN

I am an economist. Over the last ten years, my research has focused on a wide variety of economic and social issues concerning cigarette smoking and the consequences of the national "antismoking campaign". Of particular relevance to this hearing, in the past four years my research has resulted in a dozen publications relating to the cigarette excise tax.

I will restrict my testimony to three aspects of the issue being addressed by the Subcommittee: (1) the consumption and health implications of changing the federal cigarette excise tax; (2) the real value of the tax; and (3) the issue of the regressivity of the tax. I will not address such issues as the revenue implications of changing the tax and the widespread public support for retaining the current tax of 16 cents per package of cigarettes.

The essence of my findings is as follows:

(1a) If the tax is permitted to fall back to eight cents per pack, up to two million Americans will be induced to initiate or continue smoking habits when, absent the tax decrease, they would not have started or would have quit. Of particular importance, up to half a million teenagers, or one million young people aged 12 to 25, will be included in this group of Americans encouraged to smoke by the tax decrease. If one of four of these tax-induced smokers ultimately dies from the habit, this means that the halving of the tax will be responsible for causing approximately 500,000 Americans to die prematurely. Currently, between one in four and one in three smokers dies from a smoking-related illness.

(1b) Conversely, if Congress decides to increase the federal tax by eight cents to 24 cents per pack, close to two million Americans, including one million young people, will be encouraged to quit smoking or to avoid taking up the habit. This will mean that half a million premature deaths of Americans will be avoided. If the excise tax is doubled, to 32 cents per pack, an estimated 3.5 million Americans, including almost two million young people, will quit or not start smoking.

(1c) The above estimates assume that any tax change will be passed on fully to consumers. Some observers believe, however, that only a portion of an eight-cent decrease would be passed on to consumers. If this occurs, my estimates of the numbers of people induced to smoke would have to be reduced roughly proportionately. The tax change that is not passed on to consumers will represent a direct transfer of revenues from the United States Treasury to the profits of the cigarette manufacturers.

(2a) The federal cigarette excise tax was last permanently raised in 1951. In the intervening 34 years, inflation has eroded the value of the tax to about one-fourth of its real value in 1951. Simply to maintain the value of the tax at what it was in 1951 would require that the tax today equal about 32 cents per pack.

(2b) The current federal tax of 16 cents represents about 16 percent of the retail price of cigarettes. The eight-cent tax accounted for a larger proportion of cigarette price in all years to 1976. During the two decades from 1954 to 1973, the total state and federal tax share of retail price was never less than 46.6 percent. An effective moratorium on state tax increases during the next decade, combined with the unchanged federal tax, caused the tax share to fall every year to a low of 26.8 percent in 1982. Even with the increase in the federal tax to 16 cents, the total tax share of retail price stood at 32.3 percent in 1984. It has been lower than that only in two years--1981 and 1982--out of the last three and a half decades.

(3a) Proponents of decreasing the tax emphasize that the excise tax is regressive, imposing a larger relative burden on lower-income Americans. While there is some truth to this, the generalization obscures several important considerations. One is that lower-income people are probably relatively more responsive to price changes; this is suggested by research undertaken both in England and the United States. Consequently, a price increase will encourage more low-income people to quit or not start smoking, while a price decrease, which would follow a tax decrease, would cause more low-income people to smoke. Thus, while a tax decrease would decrease the tax burden on low-income people, it would increase their smoking, thereby substantially increasing the economic and health burden of smoking over their lifetimes. Recognizing that cigarette smoking is addictive, we must acknowledge that any policy than encourages more poor people to smoke is likely to impose a much greater economic burden on them than a tax that discourages them from smoking.

(3b) The tax at issue at this hearing--an eight-cent decrease--will decrease the average pack-and-a-half-a-day smoker's tax burden by $44. While this amount is certainly not inconsequential, the relative change in the burden of the tax across rich and poor smokers obviously will be minor. This relative burden is what matters in considerations of regressivity.

(3c) If Congress' concern is with tax equity, revenues from an increased cigarette excise tax could be returned to the poor through a adjustments in a wide variety of revenue and expenditure measures. While a redistributive effort of this nature could balance the (again, minor) regressivity of a tax change, a tax increase would also help many poor and young people to avoid becoming chained to an expensive and ultimately physically debilitating habit.

The analysis from which I derived most of these conclusions is described in detail in the attached paper, prepared for the Conference on Tobacco Excise Taxes, Harvard Institute for the Study of Smoking Behavior and Policy, Washington, April 17, 1985.

I am grateful for the opportunity to present this testimony.

CONSUMPTION IMPACTS OF A CHANGE IN THE FEDERAL CIGARETTE EXCISE TAX

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DRAFT - April 8, 1985
- Revised May 2, 1985

Prepared for the Conference on Tobacco Excise Taxes, Harvard Institute for the Study of Smoking Behavior and Policy, Washington, D.C., April 17, 1985.

I am indebted to the Conference participants for helpful suggestions on an earlier draft, and particularly to Thomas Schelling.

Introduction

Traditionally, legislatures enacted excise taxes to raise revenues or to make a statement about the "morality" of use of the product in question. In the latter instance, the objective was to penalize or discourage the behavior -- hence the name "sin tax." In recent years, however, excise taxes on products such as tobacco and alcohol have come to be viewed in a third dimension, one that has largely eclipsed the morality concern: excise taxes can be effective tools of public health policy. Economists have begun to evaluate the consumption impacts of such taxes as ends of inherent health interest, rather than as vehicles to estimate the revenue implications of tax-induced consumption changes (Cook, 1982; Cook and Tauchen, 1982; Harris, 1982; Laughhunn and Lyon, 1971; Lewit and Coate, 1982; Lewit, Coate, and Grossman, 1981; Warner, 1982, 1984). Furthermore, public health professionals are including excise taxation as an essential element in writings on public health policy to combat smoking and alcohol abuse (Beauchamp, 1976; Bonnie, 1978; de Lint, 1980; Ernster et al., 1985; Jacobson, 1981).*

The current debate on the federal cigarette excise tax is timely in the context of both its revenue and consumption — and hence health — implications. Regarding the former, both Congress and the Administration are searching actively for ways to diminish the swollen federal budget deficit.

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* The interest in excise taxation reflects a broader emerging public health interest in the use of economic incentives to affect behaviors related to health. Health professionals and health benefits managers in business are exploring a wide range of employment-based incentives (wage bonuses, lottery prizes), insurance incentives (deductibles and copayments, differential premiums and benefits), and tax incentives (deductibility of expenditures on wellness programs) to encourage health-enhancing changes in such areas as diet, exercise, use of seat belts, drug use, and smoking (Warner and Murt, 1984).

While any conceivable excise tax increase cannot be construed as making more than a dent in the deficit, for several reasons this tax has taken on dimensions disproportionate to its possible contribution. For one, the Administration's 1984 deficit-reduction package included several effective tax increases and only one highly visible effective tax decrease -- the decision to allow the federal cigarette tax to revert from 16 cents to 8 cents per pack on October 1, 1985, as called for in the 1982 TEFRA sunset provision. Second, a cigarette tax can be viewed as a "user fee," a politically attractive bit of nomenclature adopted in a Congressional legislative proposal. The "user fee" notion meshes neatly with the call by the Advisory Council on Social Security to earmark a cigarette tax to offset smoking-related Medicare expenditures (Rich, 1983). Furthermore, by being labeled a "user fee," the excise can parade as a non-tax (or quasi-tax) "revenue enhancer," thereby mitigating the Administration's insistance on avoiding tax increases. The political attraction is based too on the fact that fewer than a third of all adults -- the smoking population -- will bear its burden.

The timeliness of interest in cigarette consumption impacts relates specifically to the sunset provision for the current 16-cent tax, which analysts have predicted will cause smoking to increase, and more generally to the objective of the smoking-and-health community to work toward the Surgeon General's goal of a smoke-free generation by the year 2000 (Koop, 1984). The nature of the consumption impact of a change in the excise tax is the subject of the remainder of this paper. In focusing solely on the consumption impacts, the paper addresses its assigned charge. It should be noted at the outset, however, that one of the major attractions of an increase in the federal excise tax is its ability to simultaneously serve the interests of fiscal and physical health (Warner, 1984).

Price Elasticity of Demand for Cigarettes

The basis for estimating the cigarette consumption impacts of a change in the federal excise tax is an analysis of the price elasticity of demand for cigarettes. Over the past several decades, numerous economists have undertaken empirical studies of the elasticity, relying on both time series and cross sectional data (Blaine, 1983; Fujii, 1980; Lewit and Coate, 1982; Lewit, Coate and Grossman, 1981; Lyon and Simon, 1968; Lyon and Spruill, 1977; Miller, 1975; Sackrin, 1962). Studies dating since 1970 have found price elasticity estimates ranging from -0.4 to -1.3 (Lewit and Coate, 1982). According to Miller (1982) (as cited in Toder, 1985), a price elasticity of -0.7 represents the midpoint of recent studies and is the figure used by the Tobacco Institute in its analyses of the impacts of cigarette taxes.

Price elasticity estimation remains a difficult task. To date, no study has successfully addressed the complex issues in smokers' shifting from high to low tar and nicotine (t/n) cigarettes, complicated by the fact of nicotine regulation (Benowitz et al., 1983; Folsom et al., 1984; Gerstein and Levison, 1982; Kozlowski et al., 1980; Russell et al., 1980). In virtually all studies, cigarettes have been treated as a homogenous product. The exception is limited investigation of differential tar and nicotine taxes (Drayton, 1972; Harris, 1980). Other aspects of smoking behavior, such as price-induced increases in puffing frequency or smoking further down the butt, have escaped attention in all elasticity studies. While such behaviors may not be relevant to an interest in the revenue implications of a tax or wholesale price change, they are of interest in assessing the health implications of tax-related changes in price. Also of interest to health professionals are differential price responses by income class (Townsend, 1983), t/n level, years of smoking history, size of daily habit, etc. With the exception of the first of these, none of these factors has been studied in elasticity analyses, and the first has been studied only in the context of smoking in Great Britain.

An issue further complicating interpretation of elasticities is that there is good theoretical reason to expect an asymmetrical response to price increases and decreases. From survey data, the federal Office on Smoking and Health has concluded that very few people begin to smoke after the age of 21. Hence cigarette price decreases would be unlikely to induce adults to start to smoke (though they might increase smokers' daily consumption), while price increases could encourage some smokers to quit (and others to reduce daily consumption). The implication is that price response might be considerably greater in the instance of price increases than decreases. Again, no study has addressed this challenging analytical problem, though it has clear relevance to both economic and health concerns. In particular, it is central to an assessment of both the revenue and consumption implications of a change in the federal cigarette excise tax.

Finally, it is important to recognize that the lag between collection of data, analysis, and publication of results inevitably encompasses a period of several years. While this is a problem in virtually all empirical social science research, it is particularly germane when the environment for the behavior in question is rapidly changing. In the context of smoking, the composition of the smoking population has changed continuously in the past three decades (in terms of age distribution, education, sex mix, etc.), so that elasticities based on a population of smokers in 1979, for example, may not reflect the behavior of the population in 1985. Furthermore, the cigarette market itself is evolving quickly, with a new trend toward price segmentation (from low-priced generic brand cigarettes to high-priced "designer" cigarettes) introducing a factor which might alter elasticities.

These considerations emphasize the limited analytical state of the art of cigarette price elasticity estimation. Nevertheless, the state of the art experienced a substantial improvement in the early 1980s when Lewit and his colleagues (1981, 1982) produced studies of both adult and teenage price elasticities. These analyses took into account many of the biases that afflicted previous studies, including multicollinearity among cigarette price, income, and smoking trend variables in time series analyses and the effects of bootlegging on sales data in cross sectional studies. The work by Lewit and his colleagues also has the virtue of exploring differences in elasticities by age and sex. In addition, Lewit and his colleagues introduced the useful innovation of examining separate participation (prevalence) and daily consumption elasticities.

The two studies by Lewit et al. represent the best evidence on elasticities to date, and their distinguishing prevalence/quantity elasticities permits a more refined assessment of the likely consumption impacts of a change in the federal cigarette excise tax. For this reason, this paper uses the elasticity estimates by Lewit et al. to estimate the consumption effects to be expected as the result of now-plausible changes in the federal excise tax. Specifically, we will use their estimates to examine the consequences of permitting the tax to fall to 8 cents, as scheduled, and increasing the tax to 24 cents or 32 cents. Thirty-two cents — a doubling of the current tax — is approximately the level that would be required simply to maintain the real value of the tax at its value in 1951, the last time the tax was permanently increased. Twenty-four cents represents an intermediate increase equal in magnitude, though opposite in direction, to the return to 8 cents scheduled for October 1, 1985.

The salient estimates from the work of Lewit et al. are presented in Table 1. Not presented are the researchers' finding that elasticities were much greater (in absolute value) for adult men than for women, a finding they did not attempt to explain. They do hypothesize, however, that women's price responsiveness may approach that of males as female smoking patterns are becoming quite similar to those of men. Below we discuss the implications of using the non-sex-specific elasticities.

The overall adult price elasticity of -0.42 falls at the lower end of the range of recent estimates. Use of this estimate, rather than a more average figure, reflects our opinion that Lewit and Coate's (1982) work was better designed than that of earlier studies. Failure to control for bootlegging, for example, would bias upward elasticity estimates based on state cigarette sales data. In addition, use of a lower elasticity estimate assures that estimates of tax-related consumption effects will be conservative. Larger elasticities would translate into larger consumption impacts.

The total price elasticity estimates (column (1)) exhibit a pattern of price responsiveness decreasing with age, as would be expected for three reasons: (1) teens and young adults have smoking habits that are less well-defined and of shorter duration, implying less habituation or addiction and hence the potential for more price responsiveness; (2) younger people may be more inclined to start smoking as the result of a price decrease than would be older adults, as discussed earlier; (3) on average, younger people will have less disposable income so that price response may include more of an income effect. Worthy of note is that teens' cigarette demand is quite elastic while that of adults is inelastic.

One of the most important findings in the estimates of Lewit et al. is that "participation" or prevalence decisions (column (2)) account for the vast majority of total price response. All of the daily quantity elasticity estimates (column (3)) are small and statistically nonsignificant, while all but one of the participation elasticities are significant. The absence of apparent daily consumption response seems counterintuitive. One can imagine a number of adjustment mechanisms that do not involve change in the number of cigarettes smoked -- more or fewer puffs per cigarette, smoking further or less far down the cigarette, etc., — but a change in daily consumption is perhaps the most obvious response. It is possible that anomalies in smokers' reporting of their daily habits on the surveys could disguise a consumption change. The essential point is that the absence of daily consumption effects may not reflect reality and in any case does not imply an absence of price response by continuing smokers. For purposes of this paper, however, the nonsignificance of the daily quantity elasticities will lead us to examine only participation and total consumption effects of price changes.

For a discussion of the specific methods and limitations of the elasticity studies, readers should consult the original papers.

Consumption Impacts of Changes in the Federal Excise Tax

In 1984, the weighted average retail price of a pack of cigarettes was 97.8 cents (Tobacco Institute, 1984). If the federal excise tax reverts to 8 cents a pack on October 1, as scheduled, and the retail price of cigarettes falls by the same amount, average price will fall by 8.5 percent. If, instead, the tax were to be increased from its current level of 16 cents to 24 cents or 32 cents, average price would rise by 7.9 percent or 15.1

Table 1. Cigarette Demand Price Elasticities Calculated by Lewit et al. (1981, 1982)

Age Group	Elasticities		
	Total (1)	Participation[a] (2)	Quantity per day per smoker (3)
12-17	-1.40*	-1.20*	-0.25[b]
20-25	-0.89*	-0.74*	-0.20
26-35	-0.47*	-0.44*	-0.04
36-74	-0.45*	-0.15	-0.15
All adults (20-74)	-0.42*	-0.26*	-0.10

* Significant at $p < .05$

[a] Prevalence elasticity. Reflects the decision of whether or not to smoke at all.

[b] Implied from total and participation elasticities.

percent, respectively.[*], [**] Applying the elasticity figures from columns (1) and (2) of Table 1 implies that the expected percentage changes in consumption would be those presented in Table 2.

Two caveats are essential at this point. One relates to the assumption that price will change by the full and exact amount of the tax change, the assumption employed in virtually all cigarette demand elasticity studies that supply is perfectly elastic. The one study to address this issue suggests that retail prices have risen by slightly more than taxes (Barzel, 1976). Some observers conjecture, however, that pricing responses to tax increases and decreases may differ, with tax decreases not producing commensurate decreases in price. This conjecture suggests collusive behavior, a possibility in an oligopoly consisting of half a dozen firms, two of which control two-thirds of the entire domestic market. If this model is valid, it suggests that the legislated decrease in the federal tax would not produce an eight-cent decrease in retail price, mitigating increases in cigarette consumption.

The second caveat relates to the issue of asymmetrical consumption price response discussed above. If it is true that response to a price decrease is less elastic than response to a price increase, then symmetrical application of the elasticities from Table 1 will bias upward the estimate of consumption increases associated with a price decrease and downward the estimate of consumption decreases associated with a price increase. In terms of Table 2, this means that the consumption percentage change estimates for the 8-cent decrease would be too large, while those for the 16- and 24-cent increases would be too small (in absolute value).

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[*] The denominator is calculated at the mean of the pre- and post-tax change prices.

[**] Obviously we are employing an assumption that all other things remain equal. Changes in cigarette production and distribution costs and in state and local excise taxes will also affect cigarette price. Here we are concerned exclusively with the consumption impact that will result from a federal tax change.

We will return to this possibility below. For now, however, we will assume that a tax change will be reflected in a commensurate change in retail price and that price response is symmetrical and accurately represented by the elasticities estimated by Lewit and his colleagues. In this case, the figures in Table 2 represent expected percentage changes in consumption.

Table 3 presents estimates of the numbers of smokers in each age category studied by Lewit et al., as well as older teenagers (18-19) and older senior citizens (75+). Also included in the Table are estimates of average daily consumption in each group and the group's total annual consumption. Combining these with the percentage changes in Table 2 produces estimates of the quantitative changes in numbers of smokers and each age group's annual consumption. These estimates are presented in Table 4, arranged to look at each effect (i.e., participation and total consumption) across the three alternative tax changes. Estimates for 18-19 year-olds and the most elderly adults (75+) are calculated as described in the footnote to Table 4.

From Table 4 we see that if the operative assumptions held, the currently legislated eight-cent decrease in the excise tax would induce almost 2 million people to smoke who would not do so if the tax were to remain at 16 cents. This number includes both people initiating smoking habits and continuing smokers who would have quit absent the economic prod to continue. Among the 1.9 million are more than 460,000 teenagers who would begin or continue smoking as a result of the tax decrease. Adding in

Table 2. Expected Percentage Changes in Cigarette Consumption Resulting from Changes in the Federal Cigarette Excise Tax

	8-cent Decrease		8-cent Increase		16-cent Increase	
Age Group	Total	Participation	Total	Participation	Total	Participation
12-17	11.9	10.2	-11.1	-9.5	-21.1	-18.1
20-25	7.6	6.3	- 7.0	-5.9	-13.4	-11.2
26-35	4.0	3.7	- 3.7	-3.5	- 7.1	- 6.6
36-74	3.8	1.3	- 3.6	-1.2	- 6.8	- 2.3
All adults (20-74)	3.6	2.2	- 3.3	-2.1	- 6.3	- 3.9

Table 3. Estimated Numbers of Smokers, Average Daily and Annual Consumption by Age, 1982

Age Group	Number Smokers[a] (1)	(Percentage)	Average Daily Consumption of Smokers (# cigarettes)[b] (2)	Total Annual Consumption of Group (# cigarettes, billions)[c] (3)
12-17	3,279,000	(14.7)	16.0	19.1
18-19	1,577,000	(18.7)	17.5	10.1
20-25	9,665,000	(36.8)	18.0	63.5
26-35	13,722,000	(35.1)	20.3	101.7
36-74	26,963,000	(31.8)	21.8	214.5
75+	1,014,000	(9.5)	17.3	6.4
Total	56,220,000	(29.3)	20.2	415.3

[a] Age group population figures were taken from 1982 estimates by the Bureau of the Census. Smoking participation data, provided by the Office on Smoking and Health, DHHS, were from: a 1982 NIDA household survey (12-17 year-olds) in which smoking was defined as daily use of cigarettes during the preceding 30 days; the 1984 NIDA survey of high school seniors' drug use (cigarette use rate, defined as above, applied to 18-19 year-olds); and the 1983 Health Interview Survey (HIS) (adults) in which current smokers were defined as those currently smoking cigarettes and having a lifetime consumption of 100 or more cigarettes. Use of the NIDA data may produce a small underestimate of smoking by 18-19 year-olds, as high school seniors are one year younger and may have lower rates of cigarette smoking than high school drop-outs.

Age groupings of the HIS data and the studies by Lewit et al. differ slightly. The HIS rate for 20-24 year-olds was used for 20-25 here. Similarly the HIS 25-34 rate was used for 26-35. HIS broke down rates for over-35 into 35-44, 45-64, and 65+. In the present Table, a rate somewhat higher than the 65+ rate was used for 65-74 year-olds and a lower rate for 75+, the two yielding the HIS rate for the entire 65+ group. Each of these adjustments introduces potential errors of such small magnitude as to be inconsequential for the largely qualitative purposes of this paper.

(Continuation of Table 3 notes)

[b] Average daily consumption figures for teenagers were estimated from data in Exhibits A-1 and 16 in National Institute of Education (1979) and data supplied by the National Center for Health Statistics (NCHS) from the 1983 NIDA study of high school seniors' drug use. For adults, the figures were estimated from the Census and the 1983 HIS, supplemented by data provided by NCHS from a 1980 telephone poll of the HIS. The latter yielded detailed averages of daily consumption, while the 1983 HIS data were available only in categories (fewer than 15 cigarettes, 15-24, 25+).

As with the estimation of numbers of smokers in column (1), estimation of average daily consumption in age groupings corresponding to those used by Lewit et al. required a number of assumptions and interpolations. In particular, the teenage daily use estimates might better be considered educated "guesstimates." All of these figures, however, are quite consistent with earlier estimates of daily consumption as reported on surveys. It is important to keep in mind, as noted in footnote c below, that self-reports of daily consumption fall well below objective measures of consumption. As is discussed in the text, the statistical nonsignificance of the daily consumption elasticities makes examination of tax effects on the daily use variable largely a qualitative exercise anyway.

[c] Equals (1) x (2) x 365. The total estimated annual consumption is only slightly over two-thirds of the nearly 600 billion cigarettes U.S. smokers actually consume each year. This is consistent with the observation that Americans tend to underreport their levels of cigarette consumption (Warner, 1978).

Table 4. Estimated Changes in Cigarette Smoking
Attributable to Changes in the Federal Cigarette Excise Tax[a]

Age Group	8-cent Decrease	8-cent Increase	16-cent Increase
	Change in number of smokers (thousands)		
12-17	+ 334	- 311	- 594
18-19	+ 130	- 121	- 231
20-25	+ 608	- 565	-1,080
26-35	+ 513	- 478	- 911
36-74	+ 345	- 321	- 612
75+	+ 13	- 12	- 23
Total	+1,943	- 1,808	-3,451
	Change in aggregate cigarette consumption (# cigarettes, billions)		
12-17	+ 2.3	- 2.1	- 4.0
18-19	+ 1.0	- 0.9	- 1.7
20-25	+ 4.8	- 4.5	- 8.5
26-35	+ 4.1	- 3.8	- 7.2
36-74	+ 8.2	- 7.6	-14.6
75+	+ 0.2	- 0.2	- 0.4
Total[b]	+20.6	-19.1	-36.4

[a] The percentage changes for 36-74 year-olds have been applied to the oldest group of adults (75+) as well. Smokers in this age bracket may be more confirmed smokers than younger adults, perhaps implying less price response, but they are also likely to be poorer on average, implying more response to a price change. Note that these smokers constitute less than 2 percent of the smoking population. For 18-19 year-olds, percentage changes midway between those of 12-17 and 20-25 year-olds have been used.

[b] The absolute value of each of these totals is about 6 percent greater than the figures calculated by combining the prevalence and daily consumption changes directly. This results from the estimation procedure for the different elasticities used by Lewit et al.

the most price-responsive adults, those aged 20-25, we find that more than 1 million young people would join the ranks of the smoking population if the tax decrease takes effect.

An eight-cent tax increase would have a quantitatively similar opposite effect. 1.8 million people would be encouraged to quit or not begin smoking, including over 400,000 teenagers and more than half a million young adults age 20-25 (and over a million young adults age 20-35). A 16-cent increase in the excise tax, bringing the real value of the tax close to its value in the early 1950s, would encourage almost 3.5 million Americans to forgo smoking habits in which they will engage if the tax remains at 16 cents per pack. This figure includes over 800,000 teenagers and almost two million young adults age 20-35.

The aggregate annual changes in cigarette consumption are substantial in absolute magnitude — ranging from an increase of over 20 billion cigarettes to a decrease of more than 36 billion — but represent a relatively small proportion of the domestic cigarette market (from 3.4 to 6.2 percent).

Discussion

Consumption Impacts. The immediately preceding point illustrates a fundamental conclusion of this analysis: The overall relative consumption impact of conceivable tax changes is modest, only on the order of a few percentage points. But the size of the cigarette smoking population and the daily consumption of smokers mean that even modest relative changes become substantial effects in terms of absolute magnitude. This is readily illustrated by the fact that, if our assumptions hold, an eight-cent tax change will alter the size of the smoking population by less than 3.5 percent, but that 3.5 percent represents almost 2 million Americans.

The impacts of tax-induced consumption changes are of most immediate importance in the population of middle-aged and older adults, because these are the individuals most prone to experience smoking-related illness. The elasticity estimates produced by Lewit et al. show this group to be the least price-responsive, yet the sheer size of this group means that, under the operative assumptions, from 330,000 to 630,000 will alter their smoking status if the federal tax is changed.

In the long run, the toll of smoking is tied to the smoking practices of the youngest generation. There is a widespread consensus that the ultimate conquest of smoking-induced illness can come only from preventing the onset of smoking in the teenage and early adult years. In this regard, the elasticity studies of Lewit et al. and their translation into numbers of smokers are particularly important. Not only do the price responses represent large numbers of young people; they also represent substantial proportions. An eight-cent decrease in the federal excise tax would increase the ranks of teenage smokers by a tenth. A 16-cent tax increase would diminish the population of teenage smokers by fully 17 percent. The former would lead approximately 460,000 teenagers in the direction of cigarette habits; the latter would lead 820,000 teens away from dependency on cigarettes.

As discussed above, it is possible that the assumptions underlying the estimates in Tables 2-4 do not hold. Specifically, smokers' responses to price changes may not be symmetrical and the retail price of cigarettes may not adjust by an amount precisely equal to a federal tax change. In particular, it seems plausible that smoking prevalence by adults is less sensitive proportionately to a price decrease than to an increase, and that prices are sticky downward; that is, retail prices per pack of cigarettes might not fall by a full eight cents if the federal tax drops from 16 to 8 cents. If either or both of these conditions held, the consumption impacts estimated in Table 4 would be altered as follows:

- If retail price fully reflected a tax change but adult participation reponse were asymmetrical, the 8-cent tax decrease would encourage a smaller number of adults to start, resume, or continue smoking; the 8- and 16-cent increases would encourage larger numbers of adults to quit. As there is no a priori reason to assume that smoking by teenagers would be asymmetrical in a given direction, no obvious adjustment of teen response would be called for.
- If participation response were symmetrical but price was sticky downward, the estimated increases in smoking prevalence would have to be reduced to the extent that the 8-cent tax decrease was not passed on to consumers. This would apply uniformly to teens and adults.
- If price was sticky downward and adult participation was asymmetrical, the increases in smoking prevalence associated with the 8-cent tax decrease in Table 4 would clearly overrepresent the consumption impact for both teens and adults and might have to be reduced substantially. Conversely, the Table 4 decreases in smoking associated with tax increases would have to be increased for adults.

Lack of substantial empirical evidence on either of these issues makes it impossible to translate the directional adjustments indicated above into specific numbers. It is important to emphasize, however, that except in the case of no drop in retail price following a tax decrease, the qualitative findings of the analysis would hold: an 8-cent tax decrease would encourage tens or hundreds of thousands of Americans to smoke who would not otherwise do so; a tax increase of the magnitude considered would encourage many hundreds of thousands, and likely millions, of Americans to quit smoking and, in the case of youngsters, not to start.

Health Implications. The ultimate importance of tax-induced changes in cigarette consumption lies in their health consequences. No formal assessment of the health impact has been undertaken for purposes of this paper. However, the fact that one lifelong smoker of every three or four dies from a smoking-related illness can be used to produce some "ballpark" estimates of the mortality implications of the contemplated tax changes. For example, if we assume that one of every four tax-induced quitters (or nonstarters) would have died from smoking, and if we adopt the assumptions used to generate Tables 2-4, the eight-cent increase would be credited with averting the smoking-induced premature deaths of 450,000 Americans. The 16-cent increase would avoid 860,000 premature deaths. By contrast, if the eight-cent tax decrease takes effect and the above assumptions hold, over 480,000 Americans will die prematurely as a result of their tax-induced initiation or continuation of smoking habits. On average, these victims of smoking will die more than two decades earlier than they would have if they had quit smoking or never started.*

As with the consumption estimates, these numbers are sensitive to several assumptions, including those relating to pricing and symmetry of price response. Also important is recognition that medical practice and technology may improve in the future to the point that many now-fatal heart and lung diseases and cancers will become curable. To the extent that this occurs, the potential mortality savings of a tax increase or the deaths resulting from a tax decrease will be diminished. Morbidity implications are less obvious, as avoidance of death as a medical outcome can translate into increases in experienced illness and disability.

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* The author and a colleague have estimated that decreases in smoking prevalence attributable to antismoking activities, including excise taxation, had prevented over 200,000 premature deaths by 1978, with exponentially increasing numbers in the ensuing years. On average, each of the premature deaths averted translated into 23 years of additional life (Warner and Murt, 1983).

Another perhaps obvious feature of these numbers also deserves emphasis: the premature deaths averted or produced by a tax change are not realized all at once. The major consumption changes induced by a cigarette price change will occur in the youngest groups of smokers and potential smokers — teenagers and young adults. The numbers in Table 4 suggest that fully 80 percent of price-induced changes in smoking prevalence will be found in people 35 years of age or younger; nearly a quarter of all responders will be teenagers. If price responses as asymmetrical, as discussed earlier, a still larger share of smoking initiation associated with a tax decrease would be found in the youngest age groups.

The import of this distribution is that the majority of the premature deaths that will be associated with a tax decrease, or of the premature deaths avoided as the result of a tax increase, will occur two to four decades into the future. The most immediate mortality implications relate to tax-induced changes in smoking prevalence in middleaged and older adults. Given the large numbers of smokers in these age categories, this still translates into a substantial mortality implication for the near-term future; but it is only a fraction of the totals given above. For example, according to Table 4 close to a third of a million Americans aged 36 and older would quit smoking if the federal excise tax were raised 8 cents; over 630,000 would quit if the tax were doubled to 32 cents per pack. Given the earlier assumptions, these figures would translate, respectively, into 83,000 and 159,000 premature deaths that would be averted in the more immediate future, from the year of the tax increase extending into the following two decades.

It is important to emphasize that all of the numbers in this section are intended to be illustrative only, indicative of the order of magnitude of the health benefit that would follow a tax increase, or of the death toll that would result from a tax decrease. The qualitatively important conclusion is that tens of thousands of Americans will die prematurely if the excise tax falls back to 8 cents per pack. If, instead, the tax is raised, tens of thousands will lead longer, healthier lives than they will otherwise. In both instances, substantial nonfatal illness burdens will be affected as well.

Further Implications About Elasticity Estimates

All the available evidence suggests that women's smoking has not been as price responsive as that of men. As noted earlier, Lewit and his colleagues found price response among women to be much smaller and statistically nonsignificant. In the present paper, the decision was made to use the overall elasticities (i.e., not differentiated by sex) in part because the author believes that the apparent nonresponse of women, if real, may be an historical quirk, reflective of an era in which smoking's popularity among women was growing rapidly. If this is correct, a new study, using 1985 data, well might find women's price response approaching that of men. Two implications deserve emphasis:

(1) If the apparent difference in price response is real and persists today, the smoking prevalence and mortality changes estimated in this paper would derive mostly from changes in smoking behavior by men.

(2) If smoking by women has become more price responsive in recent

years, the figures presented in this paper likely underestimate the amount of smoking change and hence the mortality implications that would result from tax changes. The estimates by Lewit et al. of men's price elasticities alone are greater than the overall elasticities used here. Increases in women's price responsiveness, without decreases in men's, would lead to higher overall elasticities and hence greater behavioral and health impacts. Of course, it is possible that male smokers in 1985 are less price-responsive than male smokers of a decade earlier, partially offsetting the hypothesized increase in price response by women.

Price elasticity can be a function of the price level, particularly in its relation to income levels. When price is high relative to a country's or a group's income, a component of price response is income effect; that is, an increasing cigarette price can make smokers aware (consciously or otherwise) of its impact on their disposable income and hence more price sensitive. This phenomenon helps to explain why cigarette demand price elasticity is much higher, compared with that of the U.S., in a country like England in which price is higher and income lower. It also explains Townsend's (1983) finding that the absolute value of price elasticity is inversely related to social class in England. A similar explanation applies to the conclusion of Lewit and his colleagues that American teenagers have higher price elasticities than do adults, and that younger adults are more responsive than older adults.* Two additional implications derive from consideration of income effects:

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* The income effect is not intended to serve as the entire explanation of the differences in elasticities. Young people's smoking habits are less well-established than those of their seniors, a factor which almost certainly contributes to the greater price responsiveness of the former.

(1) It is quite possible that, as Townsend observed in England, lower socioeconomic groups would be more responsive to price changes than would be higher SES groups. Thus a tax-produced cigarette price decrease might cause relatively more poor people to join or remain in the ranks of smokers. Similarly, a tax-linked price increase might induce relatively larger proportions of the poor to forgo smoking.

(2) The inelasticity of demand for cigarettes in the U.S. is undoubtedly in part the result of the low price of cigarettes relative to income. If real cigarette price were to increase substantially over time (which would require tax increases well in excess of those considered in this paper), demand elasticities might rise as well. In that circumstance, further price increases or decreases would be expected to have proportionately larger effects on cigarette consumption and hence, ultimately, on the burden of smoking-related illness.

Finally, consideration must be given to the effects of inflation on real cigarette price and thus on the prevalence of smoking. During the more than 30 years of its existence, due to inflation the 8-cent federal excise eroded to only 2.5 cents in constant 1951 dollar value. The doubling of the tax in 1983 restored the tax to only about half of its real value in the early 1950s. Similarly, legislating any tax change in 1985, whether an increase or a decrease, will be tantamount to legislating an effective tax decrease in ensuing years, unless provision is made for inflation-compensating tax increases. This could be accomplished by shifting cigarette taxation to an ad valorem basis or indexing the tax rate to the general price level or a price index for all cigarettes (Toder, 1985). The importance of this is that even though a tax boost in 1985 would discourage smoking, without an inflation adjustment the eroding value of the new tax in 1986 and later years would encourage people to start or maintain cigarette habits.

This is not merely an academic consideration, since tax is a substantial percentage of retail cigarette price. At the present time, federal and state excise taxes constitute 32 percent of average retail price nationwide. Even with the doubling of the federal tax in 1983, this percentage represents an historically low figure. During the two decades from 1954 through 1973, the tax share of retail price was never less than 46.6 percent. An effective moratorium on state tax increases during the next decade (Warner, 1981) caused the tax share to fall annually to a low of 26.8 percent in 1982. The current federal tax constitutes 16 percent of retail price. Its predecessor, the 8-cent tax, accounted for a larger proportion in all years to 1976 (Tobacco Institute, 1984, Table 13).

Conclusion

An increase in the federal cigarette excise tax is an attractive, effective tool of health policy. Indeed, it is difficult to think of many policy measures that could have a comparable impact on the health of the public. A tax increase, however, is not the public health ideal because the inelasticity of cigarette demand means that tax increases will not eradicate smoking nor even eliminate a large proportion of it, at least for taxes on the order of magnitude discussed here. But it may be precisely that inelasticity that makes a tax increase a viable public policy option at present, because it assures that a tax increase will generate a revenue increase. No one wants to see government fundamentally dependent on cigarette excise tax revenues, but the situation in America is far from this possibility: the federal excise tax constitutes well under one percent of all federal revenues.

In 1985, increasing the federal cigarette excise tax offers several attractions. It promises to increase federal revenues, especially in the short run. It will discourage a large number, if a small percentage, of adults to give up their smoking or not to start. And it will discourage both a large number and a significant percentage of young people from starting or continuing to smoke. The legacy of a tax increase would be a significant contribution toward the realization of a smoke-free generation. The legacy of a tax decrease would be tens of thousands of avoidable premature deaths in the coming decades.

STATEMENT OF DR. H. DENMAN SCOTT, DIRECTOR, RHODE ISLAND DEPARTMENT OF HEALTH, STATE OF RHODE ISLAND, PROVIDENCE, RI

Dr. Scott. Thank you. My name is Denman Scott. I am director of the Rhode Island Department of Health, and I welcome this opportunity to address the committee. I would certainly like to applaud the Senators for their initiatives in this area and would echo what Dr. Warner says about the inevitable linkage between the issue of public health and tax policy. I wondered myself: What would I be doing coming down to a tax committee hearing, but here I am. And I think I am symbolic of that linkage, being a public health professional. If we linked the suffering and death attendant to smoking in time and space, that is taking all the sufferers from lung cancer and premature heart attacks and looking at them together, we would recognize the problem of smoking not as a national problem but as a national disaster. Why have we tolerated this problem for as long as we have? Several things come to my mind. For one, the problem is insidious. You do not get sick from the habit for a long time. To adeloscents the health effects appear particularly remote. They don't realize how vulnerable they are. Also, people like smoking. There is no question, as an ex-smoker, that I enjoyed the habit. Many people still do. You become very addicted to it. Millions know how hard it is to stop. As we have heard abundantly today, the smoking business is a major economic force throughout this country but particularly in certain sections of the country. And I think because the smoking business is so large we have had a national tolerance for the smoking which, otherwise, we would not condone. Somehow it seems to me, there has to be a national dialog on how to mitigate the economic impact on the farmer, the retailer, and others who are involved in the smoking business in order that we can move forward to deal with what I honestly think is a national disaster. There are a number of techniques, as a public health commissioner, that I am anxious to support. Clearly, we have to educate the public in every possible forum, and we don't have enough money to do this. We ought to ban smoking in public places. We ought to consider raising the access age to purchase of cigarettes to 18. And then, I think the idea before this committee of using the excise tax to discourage smoking is indeed laudible. The scientific evidence that has been produced makes it abundantly clear that this will discourage smoking, especially in those people we want to keep from starting in the first place, our teenagers and young adults. In fact, if you can make it into early adulthood, people rarely will start smoking. This is an important point for you all to appreciate. I also like the idea of a user fee, if you will. We certainly are not going to ban, or I don't think anybody is going to prohibit, smoking in any political jurisdiction in this country. But once people understand the risks that they are imposing on themselves and the costs that they are imposing on society, I think it is not unreasonable to ask them to pay a little extra for the excess health costs which they induced.

Finally, I would like to echo what Senator Durenberger said earlier and urge that the committee seriously consider allocating at least a portion of the funds to health promotion and disease prevention activities which could target most particularly our school children for efforts to keep them from starting in the first place. Thank you very much.

Senator CHAFEE. Thank you very much, Dr. Scott. Mr. Knott?

[The prepared written statement of Dr. Scott follows:]

TESTIMONY OF H. DENMAN SCOTT, M.D., M.P.H.
DIRECTOR, RHODE ISLAND DEPARTMENT OF HEALTH
ON SENATE BILL NO. 874
SEPTEMBER 10, 1985
U.S. SENATE FINANCE COMMITTEE
SUB-COMMITTEE ON TAXATION AND DEBT MANAGEMENT
ROOM 215, DIRKSON SENATE OFFICE BUILDING

I WOULD LIKE TO THANK YOU FOR THE OPPORTUNITY TO TESTIFY HERE TODAY IN SUPPORT OF SENATE BILL NO. 874.

THE PUBLIC HEALTH COMMUNITY IS FIRMLY IN SUPPORT OF THIS BILL BECAUSE OF ITS POTENTIAL TO REDUCE CIGARETTE CONSUMPTION. I AGREE WITH THE UNITED STATES SURGEON GENERAL, DR. EVERETT KOOP, WHO HAS STATED THAT "CIGARETTE SMOKING IS THE CHIEF, SINGLE AVOIDABLE CAUSE OF DEATH IN OUR SOCIETY AND THE MOST IMPORTANT PUBLIC HEALTH ISSUE OF OUR TIME." I FEEL THAT WE HAVE A RESPONSIBILITY TO DO EVERYTHING IN OUR POWER TO DISCOURAGE AND EVENTUALLY ELIMINATE CIGARETTE SMOKING.

RESEARCH BY KENNETH WARNER AND OTHERS INDICATES THAT INCREASING CIGARETTE PRICES BY 10 PERCENT LEADS TO A 4 TO 5 PERCENT DECREASE IN THE AMOUNT CONSUMED. MORE IMPORTANTLY, THIS EFFECT IS EVEN STRONGER AMONG TEENAGERS, THE GROUP WE ARE MOST INTERESTED IN REACHING. IN THIS GROUP, A 10 PERCENT PRICE

INCREASE COULD RESULT IN A 14 PERCENT DECREASE IN CONSUMPTION. AND MOST OF THIS DECREASE -- ABOUT 85 PERCENT -- WILL RESULT FROM TEENAGERS MAKING THE DECISION NOT TO START SMOKING OR TO QUIT IF THEY'VE ALREADY STARTED.

IN RHODE ISLAND, WE RECENTLY COMPLETED ANALYZING DATA FROM A SURVEY OF 11,340 STUDENTS IN 31 HIGH SCHOOLS ACROSS OUR STATE. WE DISCOVERED SOME DISTURBING TRENDS. BY THE TWELFTH GRADE, 21 PERCENT OF THE MALES AND 30 PERCENT OF THE FEMALE STUDENTS WERE SMOKING ON A REGULAR BASIS.

MEMBERS OF THE COMMITTEE, I SUBMIT TO YOU THAT IF 30 PERCENT OF OUR YOUNG WOMEN ARE SMOKING, THEN WE NEED TO ADMIT AT LEAST PARTIAL FAILURE IN OUR ANTI-SMOKING EFFORTS. WE NEED TO DEVISE NEW STRATEGIES FOR REACHING TOMORROW'S CITIZENS WITH THE MESSAGE OF SMOKING'S HEALTH HAZARDS.

REACHING OUR YOUNG PEOPLE IS CRITICALLY IMPORTANT. WE KNOW THE MOST COMMON TIME FOR STARTING TO SMOKE IS IN JUNIOR HIGH SCHOOL. RECENT EVIDENCE INDICATES THAT THOSE WHO START SMOKING AT SUCH AN EARLY AGE ARE PARTICULARLY VULNERABLE TO DEVELOPING LUNG CANCER LATER IN LIFE. THIS RISK CAN BE REDUCED BY UP TO 20 PERCENT IF THE ONSET OF SMOKING IS DELAYED UNTIL THE EARLY TWENTIES.

A STRATEGY THAT MANY RESEARCHERS, SCIENTISTS, AND PUBLIC HEALTH PROFESSIONALS AGREE HAS A HIGH CHANCE FOR SUCCESS IS THE ONE THAT IS BEFORE YOU FOR CONSIDERATION TODAY. INCREASING THE FEDERAL EXCISE TAX FROM THE PRESENT 16 CENTS TO 32 CENTS MEANS THAT THE PRICE OF A PACKAGE OF CIGARETTES IN RHODE ISLAND WILL INCREASE FROM $1.03 TO $1.19. THIS REPRESENTS A PRICE INCREASE

OF 15½ PERCENT AND COULD REDUCE CIGARETTE CONSUMPTION AMONG TEENAGERS BY ALMOST 22 PERCENT. IN ADULTS, CONSUMPTION COULD BE REDUCED BY 6½ PERCENT.

I THINK THESE REDUCTIONS ARE MEANINGFUL AND WORTH PURSUING. THE ALTERNATIVE STRATEGY -- TO ALLOW THE CIGARETTE TAX TO BE REDUCED BY 8 CENTS AS OF OCTOBER 1 -- WOULD ENCOURAGE INCREASED CONSUMPTION OF CIGARETTES AND, IN MY OPINION, IS AN UNACCEPTABLE PUBLIC HEALTH OPTION.

BOTH THE FIRST AND SECOND RHODE ISLAND STATE HEALTH PLANS HAVE CALLED FOR INCREASES IN EXCISE TAXES ON CIGARETTES AS WELL AS ALCOHOL IN ORDER TO DETER CONSUMPTION. WE FEEL IT'S A VERY SENSIBLE STRATEGY. IN FACT, I URGE YOU TO ENACT REGULAR PERIODIC SUBSTANTIAL TAX INCREASES ON CIGARETTES. SUCH INCREASES ON A REGULAR BASIS HAVE BEEN SHOWN TO BE MOST EFFECTIVE IN DETERRING CONSUMPTION, ESPECIALLY AMONG YOUNG ADULTS AND TEENAGERS. ADDITIONALLY, I FEEL IT IS APPROPRIATE FOR THOSE WHO CHOOSE TO SMOKE TO PAY AT LEAST A PORTION OF THE ADDITIONAL COSTS IMPOSED UPON OUR MEDICAL CARE SYSTEM.

IN ORDER TO REDUCE THE PREVALENCE OF CIGARETTE SMOKING IN THIS COUNTRY, WE NEED TO DO MORE THAN RAISE TAXES ON CIGARETTES. WE NEED TO IMPROVE OUR SCHOOL HEALTH EDUCATION PROGRAMS AND EDUCATE THE PUBLIC ON THE RISKS OF SMOKING AS FULLY AS POSSIBLE.

CURRENTLY LESS THAN 5 PERCENT OF OUR HEALTH DOLLAR IS USED FOR HEALTH PROMOTION AND DISEASE PREVENTION ACTIVITIES. I WOULD LIKE TO SUGGEST TO THIS COMMITTEE THAT IT CONSIDER ALLOCATING A PORTION OF THE PROPOSED TAX INCREASE TO HEALTH PROMOTION AND DISEASE PREVENTION PROGRAMS. CERTAINLY ALLOCATING A PORTION OF

THIS TAX INCREASE TO SUPPORT THE MEDICARE PROGRAM IS A LAUDABLE GOAL, WHICH I SUPPORT. BUT WOULDN'T IT MAKE SENSE TO ALSO PUT MORE DOLLARS INTO THE EFFORT TO PREVENT THE MAJOR CHRONIC DISEASES THAT ARE ABSORBING SO MANY MEDICARE DOLLARS TODAY?

HEALTH PROMOTION AND DISEASE PREVENTION ACTIVITIES ENCOMPASS A WIDE VARIETY OF PROGRAMS, INCLUDING WELLNESS CHECKS, HEALTH SCREENING, SCHOOL HEALTH EDUCATIONAL PROGRAMS, AND OTHERS. IN RHODE ISLAND, WE FEEL WE HAVE MADE A GOOD BEGINNING IN ESTABLISHING THESE PROGRAMS. BUT THERE'S MUCH MORE WE WOULD LIKE TO DO -- PROGRAMS WE ARE CURRENTLY UNABLE TO PROVIDE DUE TO A LACK OF FUNDING.

MOST PEOPLE ARE AWARE THAT MOST LUNG CANCER IS CAUSED BY CIGARETTE SMOKING. BUT MANY AMERICANS DON'T REALIZE THAT 30 PERCENT OF ALL HEART DISEASE DEATHS ARE ALSO DIRECTLY RELATED TO CIGARETTE USE. SMOKING IS ALSO RESPONSIBLE FOR DEATHS FROM OTHER TYPES OF CANCER, RESPIRATORY DISEASE, FIRES AND ACCIDENTS. AN ESTIMATED 4,000 INFANTS DIE EACH YEAR BECAUSE THEIR MOTHERS SMOKED WHILE PREGNANT.

IN FACT, SMOKING ACCOUNTS FOR AN ESTIMATED 300,000 DEATHS EACH YEAR IN THE UNITED STATES. THIS IS THE EQUIVALENT OF 750 747 JUMBO AIRLINERS GOING DOWN EACH YEAR WITH 400 PERSONS ON BOARD AND NO SURVIVORS.

SMOKING IS ALSO RESPONSIBLE FOR DISEASES SUCH AS EMPHYSEMA WHICH CAUSE YEARS OF DISABILITY AND SUFFERING FOR THEIR VICTIMS. CARING FOR THESE UNFORTUNATE INDIVIDUALS ADDS A LARGE BURDEN TO OUR MEDICAL AND SOCIAL SUPPORT SYSTEMS. AS A HUMANE SOCIETY, WE ARE COMMITTED TO CARING FOR THESE INDIVIDUALS. BUT WOULDN'T IT

BE SENSIBLE - AND MORE HUMANE - TO TAKE STEPS NOW SO THAT OUR CHILDREN IN FUTURE YEARS WILL NOT BE FACED WITH CARING FOR A LARGE ELDERLY POPULATION DISABLED BY SMOKING RELATED AND PREVENTABLE DISEASE?

IN CONCLUSION, I URGE YOUR SUPPORT FOR SENATE BILL NO. 874 AND RECOMMEND YOU ADOPT ANNUAL TAX INCREASES THAT WOULD CREATE A STRONG DETERRENT TO CIGARETTE PURCHASE. I ALSO REQUEST THAT YOU ALLOCATE A PORTION OF THIS TAX TO A HEALTH PROMOTION AND DISEASE PREVENTION FUND. I BELIEVE THAT THESE TWO MEASURES TAKEN TOGETHER WILL GO A LONG WAY TOWARDS REDUCING THE PREVALENCE OF CIGARETTE SMOKING AND CREATING A HEALTHIER AMERICA.

THANK YOU.

STATEMENT OF K. PAUL KNOTT, CHAIRPERSON, SECTION ON PUBLIC HEALTH EDUCATION, AMERICAN PUBLIC HEALTH ASSOCIATION, WASHINGTON, DC

Mr. KNOTT. Thank you, Mr. Chairman. My name is Paul Knott. I am an evaluation officer with corporate communication at the American National Red Cross at Washington, DC. I am here today, however, representing the American Public Health Association as the chairperson of its public health education section, the fourth largest in the association. The American Public Health Association, founded in 1872, is a nongovernmental professional organization whose membership, including 49 State and local affiliates, is comprised of approximately 50,000 health professionals, consumers, and leaders from Government and industry who are interested in promoting high scientific standards, action programs, and public policy for good health. I came here today prepared to indicate APHA's strong endorsement for raising the Federal excise tax on a pack of cigarettes to 32 cents, and that I will clearly state. I am also pleased to see the Durenberger bill and want to indicate that APHA is supportive of it, particularly supportive of the allocation approach and the notion of disease prevention and health promotion. This move is advocated to discourage smoking, the Nation's No. 1 preventable cause of death. Cigarette smoking accounts for some 340,000 deaths each year and debilitates another 10 million people annually. Studies have shown that the price of cigarettes including studies quoted here today may have a significant effect on cigarette sales to teenagers and young adults. Results of previous studies have indicated that doubling of the tax in 1982 caused one and a quarter million adult Americans to stop smoking, and one-half million teenagers to stop or not start smoking. In one year alone, from 1982 to 1983, cigarette consumption in the United States fell 5 percent. And estimates are that consumption among teenagers fell by 14 percent, largely because of teens who chose not to take up smoking. In addition, adult smoking decreased by 4 percent. Evidence shows that these decreases were due in large part to the increased price of cigarettes. As you know, from 1951 to 1982, the Federal tax was 8 cents per pack. That level was raised to 16 cents in 1982, but the same law that imposed the increase also requires the return—the sunset—on October 1, 1985, to the 8 cent level. Allowing the tax to be reduced will be a tragic mistake for the public health and the public treasury. Reducing the excise tax is the wrong message to send to smokers and to those who are considering starting the habit. It also seems to be somewhat Jekyll and Hyde. Congress recently mandated new rotating health-specific warnings on the labels of cigarette packs, which are scheduled to go into effect October 1. Now, these new warning labels are stronger than any which we have ever had and indicate the dangers of smoking. Now, Congress is contradicting this attempt—these strong messages—by considering allowing the price of cigarettes to go down and thereby condoning cigarette smoking or supporting cigarette sales and smoking. Some argue that we should not raise the Federal tax since many States are increasing State excise taxes to make up the difference. This is clearly not the case. While APHA has been advocating such State action, only 11 States have passed laws which are contingent on the Federal reduction. In these States, the increase would be nullified if the Federal Government again raises the Federal excise tax to 16 cents. Only seven other States have increased the excise tax, no matter what the Federal Goverment does. Now, some would argue and have argued today that minorities would be adversely affected by raising the tax. It is a fact, however, that the health status of minorities, especially black people, is on an average lower than whites, and that more minorities as a proportion of the population smoke. And we have already indicated that research has shown that raising the excise tax on cigarettes does discourage smoking, and the recently completed Harvard University study indicated that thousands of people would not begin or would not continue smoking if the tax was raised, thereby sparing them lost dollars and suffering caused by smoking. As public health professionals, the APHA members view any decrease in the smoking behavior of minorities as beneficial to their morbidity and mortality. Our concern today, of course, is not only to reduce smoking in adults but to prevent children from starting. The fact that thousands of children who light up for the first time every day are doing so at an earlier age than their parents is ominous. Let me conclude, Senator.

Previous decisions notwithstanding, a significant tobacco excise tax is a wise move. It is our belief that cigarettes are already cheap enough and that an increase in the price would discourage some smokers. If Congress now imposes a tax increase on cigarettes, it will in one stroke negate the harmful effects of the recent action that reduced the tax and at the same time obtain much needed additional Federal funding, but most importantly prevent the death and disability of millions of Americans. Mr. Chairman, thank you for the opportunity to speak today.

Senator CHAFEE. Thank you.

[The prepared written statement of Mr. Knott follows:]

STATEMENT OF K. PAUL KNOTT, EVALUATION OFFICER, CORPORATE COMMUNICATION, AMERICAN RED CROSS, WASHINGTON, DC

Mr. Chairman, I am K. Paul Knott, Evaluation Officer, Corporate Communications at the American Red Cross in Washington, DC. I am here today representing the American Public Health Association as its Chairperson of the Public Health Education Section. The American Public Health Association, founded in 1872, is a non-governmental professional organization whose membership, including its 49 state and local affiliates, is comprised of approximately 50,000 health professionals, consumers, and leaders from government and industry who are interested in promoting high scientific standards, action programs, and public policy for good health. APHA strongly endorses raising the federal excise tax on a pack of cigarettes to 32¢. This move is being advocated to discourage smoking, the nation's number one preventable cause of death.

We believe that Congress should raise the excise tax on cigarettes to 32 cents a pack since this is the level that the tax would be if the tax instituted by Congress in 1951 had been adjusted for inflation every year. The Treasury Department estimates $8.8 billion in revenue will be generated by this increase.

More importantly, cigarette smoking accounts for some 340,000 deaths each year and debilitates another ten million people. Studies have shown that the price of cigarettes may have a significant effect on cigarette sales to teenagers and young adults. A doubling of the tax in 1982 caused one and a quarter million adult Americans to stop smoking and one-half million teenagers to stop or not start smoking. In one year alone, from 1982 to 1983, cigarette consumption in the United States fell 5 percent, and estimates are that consumption among teenagers fell by 14 percent, largely because of teens who chose not to take up smoking. In addition, adult smoking decreased by 4 percent. Evidence shows that these decreases were due to the increased price of cigarettes.

From 1951 to 1982, the federal tax on cigarettes was 8 cents per pack. That level was raised to 16 cents per pack in 1982, but the same law that imposed the increase also required that the tax return to 8 cents per pack on October 1, 1985. Allowing the tax to be reduced will be a tragic mistake for the public health and the public treasury. Reducing the excise tax is the wrong message to send to smokers and to those who are considering starting the habit. Congress recently mandated new rotating health specific warning labels for cigarettes which are scheduled to go on packages in October. These new warning labels emphasize the dangers of smoking. Now Congress is contradicting these strong messages by allowing the price of cigarettes to go down.

Some argue that we should not raise the federal tax since many states are increasing state excise taxes to make up the difference. This is wrong. While APHA has been advocating such state action, only eleven states have passed laws contingent on the federal reduction. In these states, the increases will be nullified if the federal government again raises the federal tax to 16 cents. Only seven states have increased their excise tax, no matter what the federal government does.

Some argue that minorities will be adversely affected by raising the excise tax. It is a fact, however, that the health status of minorities, especially blacks, is on an average lower than whites and that more minorities as a proportion of the population smoke. As we have already indicated, research has shown that raising the excise tax on cigarettes does discourage smoking. As public health professionals, we view any decrease in the smoking behavior of minorities as beneficial to their morbidity and mortality.

Our concern today, of course, is not only to reduce smoking in adults but to prevent children from starting. The fact that the thousands of children who light up for the first time every day in America are doing so at an earlier age than their parents is ominous. Not only are they smoking younger, but they are also smoking more. We also know that young growing tissues are more susceptible to carcinogens than are mature ones. This generation's children are on a collision course with cancer and other tobacco-related diseases. Consequently, unless their smoking is curbed, in 20 to 30 years they will suffer the same diseases as their smoking parents, except that many more people will be victims and their diseases and deaths will occur at an earlier age. Around the country we are beginning to see examples of this by the frequency in which younger women, many in their late thirties, are showing the ill effects of tobacco. Not only are lung cancers rising in this young group, but so are heart attacks, subarchnoid hemorrhages, phlebitis, troublesome pregnancies and birth defects.

It has been known since 1957 that babies born to women who smoke during pregnancy are, on the average, 200 grams or 7 ounces lighter than babies born to comparable women who do not smoke. This difference is a direct effect of smoking and is not produced by diminished intake of calories or specific nutritional components. It is now believed that the retardation in intrauterine growth, as manifested by the decrease in birth weight, is the result of diminished delivery of oxygen and other nutrients to the developing embryo and fetus.

It is our belief that cigarettes are already cheap enough, and that an increase in the price of cigarettes will discourage some smokers not to start and will make the purchase of cigarettes more difficult for young smokers. If we are to achieve the U.S. Surgeon General's goal, endorsed by APHA, of a non-smoking society by the year 2000, Congress must act to remedy this situation. If Congress now imposes a tax increase on cigarettes it will in one stroke negate the harmful effects of the recent action that reduced the tax. At the same time, it will obtain much needed additional federal funding and most importantly, prevent the death and disability of millions of Americans.

Senator **Chafee**. This statement that you make on the middle of page 3 about pregnant women who smoke, that their babies are 7 ounces lighter than babies born to comparable women who do not smoke, can you substantiate that?

Mr. **Knott**. Yes, Senator. I would be glad to provide the study for you.

Senator **Chafee**. Why don't you just tell me? Where does it come from?

Mr. **Knott**. The gentleman on my left is Mr. Richard Gilbert, from the Government Relations Office. I would like him to respond.

Mr. **Gilbert**. I do not have the research with me, but I can dig it up at my office, and I will send it to you.

Senator **Chafee**. All right. I think your comments, on the previous page, about children who start smoking are interesting. They are smoking younger and smoke more. Their tissues, while they are young, are more susceptible to carcinogens, and thus they will come down with the diseases their parents had but at an earlier age. All right. Thank you all very much.

Mr. **Knott**. Mr. Chairman, could I indicate the source of that quote? A publication by the National Institutes of Health on Medicine for the Layman indicates on page 30: "Babies born to women who smoke during pregnancy are an average of 200 grams or 7 ounces lighter."

Senator **Chafee**. All right. Why don't you send that in to us? I would like to see that.

Mr. **Knott**. I will be glad to.

Senator **Chafee**. Thank you for coming—all of you. Each of you have done a lot of work, and all the witnesses on the previous panels have been excellent, too. We appreciate it. That concludes this hearing. I will get Mr. Kerrigan from the Smokeless Council in some time for a brief hearing, and we will try to let people know when he will be here.

Mr. **Knott**. Thank you.

[The prepared written testimony of Mr. Michael J. Kerrigan and the National Institutes of Health report follow:]

Smokeless
Tobacco
Council, Inc.

September 4, 1985

Mr. William M. Diefenderfer
Chief of Staff
United States Senate
Committee on Finance
Room SD-219
Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Diefenderfer:

The Smokeless Tobacco Council, Inc. has observed with great concern recent legislative proposals introduced in Congress which would impose an excise tax on smokeless tobacco products. Two of these bills--H.R. 3064 and H.R. 3078--propose an excise tax of such proportions (16 cents per ounce in H.R. 3064 and 32 cents per ounce in H.R. 3078) as to transcend mere taxation, and instead constitute regressive, punitive measures which impose an inequitable and potentially ruinous burden on the smokeless tobacco industry. These bills violate traditional principles of tax equity by both imposing a greater tax burden on low income workers than the wealthy; and by imposing a greater tax on smokeless tobacco than on other products on which an excise tax is imposed.

In addition to the basic equity concern, it is difficult to understand exactly how an excise tax on smokeless tobacco products can be reconciled to the overall goal of tax reform and simplification. Adding another provision to the federal tax code--on a product that is consumed primarily by blue collar workers who earn under $25,000 per year--does not seem to fit the criteria of fairness, loophole closing, or simplification.

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Because of these concerns and due to the fact that Senator Chafee has shown an interest in this subject, the Smokeless Tobacco Council, Inc. commissioned Dr. Robert D. Tollison, Center for Study of Public Choice, George Mason University, to conduct an economic analysis of the implications of these measures. Dr. Tollison's analysis is being submitted to this committee in order to provide it with additional information regarding the regressive, inequitable and punitive nature of the proposed legislation. The Smokeless Tobacco Council, Inc. hopes that this analysis will assist the Senate Committee on Finance's Subcommittee on Taxation and Debt Management in its deliberations and convince Congress that these legislative proposals lack merit and should be rejected.

Sincerely,

Michael J Kerrigan

Michael J. Kerrigan
President

/mvm
Enclosures

Smokeless
Tobacco
Council, Inc.

SMOKELESS TOBACCO COUNCIL, INC. STATEMENT IN OPPOSITION TO SMOKELESS TOBACCO EXCISE TAX

Congress is currently considering at least two bills which would impose an excise tax on smokeless tobacco products of such proportions as to constitute a confiscatory attempt to destroy one of America's oldest industries. One bill, H.R. 3064 calls for an excise tax in the amount of 16 cents per ounce; another, H.R. 3078, would levy an excise tax of 32 cents per ounce. These bills are unfair and regressive measures which would impose an unprecedented tax burden on an industry which always prided itself on paying its fair share of taxes.

Excise taxes are regressive because they impose a greater tax burden on low income workers than on the wealthy. An excise tax on smokeless tobacco is particularly regressive because the average household income of smokeless tobacco users is significantly lower than that of the general public.

The imposition of this excise tax cannot be justified by proposals to earmark the revenue generated for Medicare and Medicaid because there is no proof that the use of smokeless tobacco has attendant social costs. Even if such costs did exist, however, low income consumers of smokeless tobacco should not be singled out to pay a special charge for medical care.

The proposed bills impose a tax of such magnitude as to be confiscatory. The tax burden sought to be imposed is unprecedented and would confiscate an amount equal to half of the industry's total revenue. Clearly, these bills threaten the very survival of the smokeless tobacco industry. These bills are particularly unfair because the smokeless tobacco industry already pays its fair share of federal taxes. Approximately 40 percent of smokeless tobacco companies' income is paid in federal income taxes. This percentage is far above the average corporate tax burden.

In the current environment of tax reform and simplification, an excise tax on smokeless tobacco products is completely inappropriate. Such a levy actually complicates the federal tax structure and violates the basic principles of true tax reform--establishing a level playing field for all businesses and basic tax liability on an individual's ability to pay.

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Medicine for the Layman

Behavior Patterns and Health

U.S. DEPARTMENT OF
HEALTH AND
HUMAN SERVICES
Public Health Service
National Institutes of Health

Cigarette smoking during pregnancy affects not only the fetus, but also the health of the newborn baby and possibly the future development of the infant and child. Babies born to women who smoke during pregnancy are an average of 200 grams lighter than babies born to comparable non-smoking women. A smoker has about twice the risk of giving birth to a low birth weight baby at full term, nearly 70 percent greater risk for spontaneous abortion, almost 40 percent greater risk for premature birth, and a 25 percent greater risk for perinatal death. There is some evidence, though inconclusive, that children of mothers who smoke during pregnancy may still be slightly smaller and show lower levels of achievement by the time they are seven years old.

Theory: Nicotine, carbon monoxide, and the polycyclic aromatic hydrocarbons in cigarette smoke act directly on the fetus and on the placenta to affect pregnancy outcome.

Nicotine affects the fetus and the placenta by raising fetal blood pressure, lowering blood oxygen levels, and increasing blood acidity. It can cause placental calcification and impair the placenta's ability to take up amino acids from maternal blood. Animal experiments have shown that carbon monoxide exposure during pregnancy causes lower fetal weight; decreased levels of brain protein, DNA, and neurotransmitters; and increased perinatal mortality.

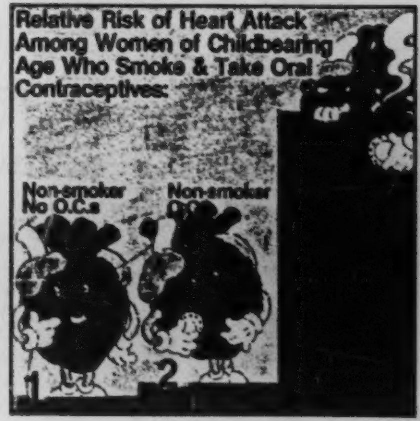
Fact: Passive smoking presents a risk to the health of some nonsmokers.

Involuntary inhalation of other people's cigarette smoke can precipitate or exacerbate symptoms of existing asthma and cardiovascular or respiratory diseases. Some studies have even suggested the possibility of increases incidence of lung cancer among non-smoking spouses of smokers.

Fact: The risk of smoking can be compounded when exposure occurs in conjunction with another health risk.

Non-smoking asbestos workers, for example, have a slightly increased risk for lung cancer, but smoking asbestos workers increase their risk of lung cancer by as much as 90 times. Smoking miners, rubber workers, cotton mill workers, and chemical workers are also at greater risk for certain cancers and pulmonary diseases.

Smoking also compounds the risk for women who take oral contraceptives. Taking the pill roughly doubles a woman's chances for heart attack or stroke; women who smoke and take the pill are 20 times as likely to suffer a heart attack or stroke.



Senator **Chafee**. We are adjourned.

[Whereupon, at 12:24 p.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

September 17, 1985

The Honorable Paul S. Trible
Committee on Finance
Cigarette Excise Tax Proposals

Mr. Chairman, I appreciate the opportunity to appear today to discuss the proposals before the Committee affecting the excise tax on cigarettes.

As we all know, the current 16 cents per pack excise tax is scheduled to sunset back to its former level of 8 cents next month on October 1. I understand that the Committee will consider repealing this sunset; in effect, leaving the tax at 16 cents per pack. The Committee may possibly even consider raising the tax above that level.

Mr. Chairman, I recognize the importance of identifying reasonable additional federal revenues in light of our $200 billion annual deficit and $2 trillion national debt.

However, I believe that the issue before the Committee today is not simply one of raising additional federal revenues. I believe that it is rather one of equity and fairness.

First, Mr. Chairman, when tobacco states Senators and Congressmen agreed in 1983 to increase the federal tobacco excise to 16 cents, they did so with the understanding and agreement that it would sunset back to 8 cents in October of 1985. To undermine this agreement is unfair to tobacco consumers and producers alike, because, as we all know, to tax something is to have less of it. Higher taxes mean fewer cigarettes consumed and less tobacco produced and sold to benefit both farmers and manufacturers.

Moreover, fourteen states have already increased their state excise tax in anticipation of the sunset of the federal excise tax. Twenty-five others are considering such increases. In effect, if the sunset is not allowed to go forward, we will be raiding state treasuries of much-needed revenues.

Second, Mr. Chairman, this proposal is inherently unfair because excise taxes in general, and tobacco excise taxes in particular, are among the most punitive in our tax code.

This regressive, selective consumption tax falls most heavily on the poor and lower income classes. The burden of cigarette excise taxes is more than five times greater on smokers with incomes below $10,000 than on smokers with incomes above $50,000. Thus, its burden increases drastically as consumers income decreases. It's unfair to discriminate against low-income consumers who choose to spend a portion of their income on tobacco.

Tobacco excise taxes also burden industry. They result in reduced revenues from lower sales, worker layoffs, reduced tobacco acreage, farmer bankruptcies and general economic decline. As a result of the 1983 tax increase, the industry lost 12,500 jobs and $650 million in potential income.

Mr. Chairman, 55 million American smokers already pay their fair share of taxes--in 1984, they contributed more than four and three-quarters of a billion dollars to federal revenues. Total federal, state and local tobacco taxes now are close to $10 billion.

In sum, excise taxes are unfair to consumers because they are regressive taxes. They are also inequitable with respect to producing and manufacturing industries and labor. Finally, they encroach upon revenues more appropriately reserved for state and local governments.

I urge the Committee to retain the current sunset of the 16-cent excise tax. The tobacco industry already contributes more than its fair share to our federal treasury.

THE AMERICAN ACADEMY OF
OTOLARYNGOLOGY—HEAD AND NECK
SURGERY, INC.

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EXECUTIVE VICE PRESIDENT
JEROME C. GOLDSTEIN, MD

September 6, 1985

Senator John H. Chafee
SD-340 Dirksen Senate Office Building
Washington DC 20510

Dear Senator Chafee:

I'm writing to you in regards to S 874. I represent an organization of some 7,800 otolaryngologists-head and neck surgeons. We are the physicians most concerned with the medical and surgical diagnosis and therapy of diseases afflicting the head and neck exclusive of the eyes and brain. As such, we manage the majority of the patients in this country afflicted with head and neck cancer. Cigarette smoking is the single most preventable cause of death in the US! As a group, we are most impressed with the relationship of tobacco to cancer of the head and neck. By this we specifically mean cancer of the lips, tongue, mouth, palate, larynx (voice box) and other areas of the throat. The causes are most likely multi-factorial, but much hard data supports that this disease is virtually unknown in those populations that neither drink nor smoke, while those unfortunate patients afflicted with this disease most often show a history of heavy participation in both of these "pleasures".

Our concern is not only with the treatment of patients afflicted with cancer of the head and neck, but also whatever we might do to decrease the incidence of this affliction. In this regard, we have undertaken a significant education campaign to attempt to decrease the incidence of smoking by our patients. As an example, we have produced a pamphlet for doctors' waiting rooms entitled "Cancer of the Head and Neck" in which we clearly point out the relationship between smoking and cancer. We also have a second pamphlet entitled "Smoking: The Hows and Whys of Quitting".

We feel that Congress has a significant obligation to support our efforts in this regard. We are most impressed with the data that indicates that an increase in the cigarette tax to $.32 per pack (the level it would have been at had it been adjusted for inflation since 1951) would have a significant deterrent effect on young people smoking, as well as decreasing the incidence of smoking by adults. For example, studies indicate that a 10% increase in the price of cigarettes will cause a decline in smoking among adults of 4% and among teenagers of 14%. These studies have been corroborated by the U.S. Department of Agriculture. Dr. Warner, in the Harvard University study, estimated that an increase in the cigarette excise tax to $.32 a pack would produce a 21% decline in smoking by teenagers and a 6.8% decline by adults.

We would further ask that a portion of the increased revenue resulting from the tax increase should be used to assist the Medicare system for smoking related costs. The annual cost of smoking to our medical care system in 1980 was $13 billion dollars, not to mention the $25 billion dollars annually lost to our economy due to sick days, lost productivity and lost wages. These data are from the National Center on Health Statistics. It seems only fair and appropriate that smokers begin to shoulder more of the cost which their habit imposes on society.

I thank you for the opportunity to submit these comments and for your consideration of these requests.

Very truly yours,

Jerome C. Goldstein M.D. FACS
Executive Vice President

American Farm Bureau Federation

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September 6, 1985

Honorable John Chafee, Chairman
Subcommittee on Taxation and Debt Management
Senate Committee on Finance
Room SD 221
Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

We understand that on September 10 the Subcommittee on Taxation and Debt Management will hold a hearing on proposals to retain the current 16 cents per pack excise tax on cigarettes which is scheduled to drop to 8 cents per pack on October 1, 1985. The American Farm Bureau Federation supports allowing that reduction to occur as scheduled under existing law. This was to be a temporary increase in the cigarette excise tax and should be allowed to terminate on October 1, 1985.

In July, we advised the House Ways and Means Committee that if it decided to continue the tax at the current level, 2 cents per pack should be earmarked for the payment of the cost of the current tobacco program. The Committee accepted a compromise and earmarked 1 cent of the current 16 cents per pack for a five-year period. While the House Ways and Means Committee's apportionment will help pay part of the tobacco program's cost, Farm Bureau believes that a 2 cents per pack set-aside is necessary. We believe that it is only fair that if the excise tax is extended at the current level, that tobacco farmers have an adequate portion set aside to pay for the cost of the current tobacco program.

We appreciate your consideration of our views and urge that this letter be made a part of the hearing record.

Sincerely,

John Datt

John C. Datt
Executive Director
Washington Office

Statement of the American Society of Internal Medicine
to the
Senate Finance Committee
for the Record of the September 10, 1985 Hearing
on
Expiring Cigarette Excise Tax Provisions

The American Society of Internal Medicine (ASIM) is an organization which represents physicians across the country who specialize in internal medicine. ASIM has spent considerable time studying ways to decrease the rate of growth in health care costs and the federal budget deficit. ASIM has reviewed the proposals included in the President's FY 1986 budget plan, and has made specific recommendations concerning the federal excise taxes on tobacco products. We welcome this opportunity to share our suggestions with you.

1. OVERVIEW

Federal cigarette excise taxes, first imposed during the civil war, remaining stagnant at 8 cents per pack from 1951 to 1982. The Tax Equity and Fiscal Responsibility Act of 1982 raised the excise taxes on tobacco products from 8 cents to the present level of 16 cents per pack beginning January 1, 1983. However, this increase is temporary, and will automatically revert to 8 cents on October 1, 1985 unless Congress enacts appropriate legislation.

ASIM is opposed to the rollback of the federal cigarette excise tax, based on the large body of evidence that shows that a decrease in this tax would encourage people to smoke; drain billions of dollars in medical care resources as a result of smoking-induced illnesses; and drastically reduce federal tax revenues. ASIM believes strongly that the federal excise taxes on tobacco products should be doubled to 32 cents per pack, rather than decreased. The Society also believes the increased revenue should be earmarked to the Medicare Trust Fund. This paper summarizes some of the hard research data that supports the health and economic benefits of maintaining--or increasing--the current level of taxation of tobacco products.

2. PROBLEM

Policy Analysis, Inc., a Massachusetts research firm that deals with health issues, analyzed the smoking-related medical expenditures an individual averages in his/her lifetime. The study specifically reported that a man 35 to 44 years of age, who smokes over two packs of cigarettes a day, would average $58,987 in medical expenses and lost wages in his lifetime. A woman in the same category would average $20,152 in these hidden costs. (A woman's loss appears lower only because her earning potential is lower.) A man and woman 55 to 64 years of age, who smokes over two packs a day, would total $15,945 and $11,717 respectively in medical expenses and lost income.[1]

Furthermore, some economists believe that the study's estimates are low, because it does not include the costs of all types of smoking-related diseases (only lung cancer, heart disease, and emphysema), and the figures were adjusted to reflect the fact that not all smokers develop such diseases. Thus, for a person who does contract such an illness, the hidden costs would be significantly higher.[2]

On a national scale, the economic toll of smoking is estimated to cost $49 billion annually. Of this sum, $15 billion in medical care resources, more than 5% of the nation's total direct health care costs, is consumed as a result of smoking-related illnesses. Annual productivity loss accounts for $34 billion, due to excess morbidity, disability and premature death.[3]

3. SOLUTION

Given the evidence that tobacco products eventually extract phenomenal amounts of resources from the health care system--resulting in higher federal expenditures on Medicare, Medicaid and other health programs--it is apparent that the federal government has underutilized excise taxes as a means to generate funds. Although the annual costs associated with smoking have been rapidly increasing since 1951, Congress waited 31 years before increasing the 8 cent federal excise tax on cigarettes to 16 cents. With the long due 16 cent excise tax awaiting its rollback in October 1985, the health and financial benefits accruing from the higher tax risk reversal. Conversely, if Congress chooses to increase the excise tax on tobacco rather than revert it, the benefits would be multiplied. A 32 cent federal excise tax on cigarettes would require tobacco users to contribute a larger share of the Medicare program's revenue, would raise revenue to reduce the federal deficit, and would deter non-smokers from developing a cigarette habit.

A. USER FEE

Cigarette smoking, by consuming large amounts of the nation's health care resources, places an average annual economic burden on each non-smoking, working-age, American adult of more than $100 in taxes and health insurance premiums.[4] Because smokers generate higher health care costs, subsequently increasing Medicare expenditures, it is reasonable to expect buyers and users of tobacco to contribute a larger amount of revenue to the Medicare program. Non-smokers should not be required to provide such subsidies to smokers. A 32 cent federal excise tax on cigarettes would significantly help replace the resources which patients of smoking-related illnesses drain from the system, and would shift more of the tax burden from non-smokers to smokers.

B. REVENUE RAISING CAPACITY

The federal excise tax on tobacco products has serious implications for the federal deficit. In one year, the 16 cent tax raised over $5 billion for the Federal Treasury. According to the Department of the Treasury, an increase to 32 cents per pack of cigarettes--the level it currently would be if the tax had been adjusted for inflation yearly since 1951--would produce $8.5 billion a year in revenue. However, if the tax returned to 8 cents per pack, the yielded revenue would drop to $2.5 billion a year.[5] This is a substantial decrease in income for the federal government.

The 32 cent cigarette excise tax would generate a significant $6 billion more for the Federal Treasury than would the tax after the rollback. Earmarking the increased revenue of the 32 cent tax to the Medicare Hospital Insurance Fund would help replenish the Fund, which otherwise will be exhausted as early as the mid 1990's, or as late as the end of this century (depending on economic conditions), according to the Congressional Budget Office. The CBO projects that once the HI Trust Fund is depleted, trust fund deficits will continue to grow rapidly.[6] By increasing the excise tax now, and earmarking the revenue to the HI Trust Fund, Congress can further forestall the date of insolvency, thus allowing more time to study and develop realistic proposals for improving the program's long term fiscal stability. During a period of soaring deficits, the 32 cent cigarette excise tax is needed to help restore the solvency of the Medicare program and to help alleviate the overall federal budget deficit.

C. SMOKING-DETERRENT FUNCTION

Increased excise taxes have a significant effect on smoking behavior. The United States Department of Agriculture found that national cigarette consumption decreased by 5% from 1982 to 1983, largely as a result of the increase in the federal excise tax.[7]

Most remarkable is the deterrent effect the tax increase has on America's young people. The price elasticity demand for cigarettes is .42 for adults and 1.4 for teenagers. Thus, a 10% increase in the price of cigarettes, or a 12 cent excise tax increase, would lower the amount consumed by 4.2% for adults and 14% for teenagers. Most of this decrease is derived from individuals who chose not to take up smoking.[8] Thus, a 32 cent tobacco excise tax would result in fewer people smoking and consequently, less medical care resources being consumed by smoking-induced diseases.

4. IS THE TAX INCREASE REGRESSIVE?

Opponents of an increase of the excise tax on tobacco products argue the tax is regressive because cigarette smokers come predominantly from lower income groups. However, this argument has less substance than it appears. First, the poorest groups in our society have lower smoking rates than middle-income groups. Second, smoking rates among women tend to increase with income. Also, many low-income smokers are teenagers or young adults. This group tends to be temporarily poor, and will respond to a tax increase primarily by quitting or choosing not to start smoking. Finally, an increase of the cigarette excise tax is not completely passed on to the consumers, to the extent that the burden of the tax increase will be shared by the stockholders of cigarette manufacturing companies, the owners of domestic tobacco allotments, and foreign sellers for imported tobacco.[9] In short, this is not a clearly or highly regressive tax.

5. INTERSTATE CIGARETTE BOOTLEGGING

Opponents of an increase in federal excise taxes also argue that the level of taxation on tobacco products primarily should be established by the states. State cigarette taxes range from $0.02 per pack in North Carolina to $0.21 in Connecticut, Florida and Massachusetts. Wide disparities in state tax rates and hence, retail prices of cigarettes, produce an incentive for illegal cigarette smuggling. Increases in individual states' cigarette taxes may only encourage interstate bootlegging.[10]

On the other hand, since a federal excise tax increase would be uniform across the country, interstate differentials would not be affected. Therefore, the problem of bootlegging would not be exacerbated. States could retain their individual taxes, and obtain additional revenues from a shared federal tax without encouraging bootlegging activity.

CONCLUSION

In conclusion, ASIM strongly encourages the Committee to consider an increase of the federal excise tax on cigarettes to 32 cents per pack and a dedication of the increased amount to the Medicare Trust Fund. An increase of the excise tax on tobacco products would serve three outstanding purposes: it would establish a user fee so that non-smokers would not have to compensate for smokers' higher health care costs; it would raise substantial revenue for the Federal Treasury in general and, specifically, the

Medicare program; and it would decrease cigarette consumption and deter America's youth from developing new cigarette habits. Furthermore, legislation increasing the excise tax would be neither highly regressive nor conducive to bootlegging.

Although the American Society of Internal Medicine feels actions of the Senate Finance and House Ways and Means Committees to make permanent the 16 cents per package excise tax on cigarette are steps in the right direction, the Society believes that an increase to 32 cents remains a desirable objective. ASIM encourages Congress to pass bills such as H.R. 1508, H.R. 1561, H.R. 1594, H.R. 1969, S. 874, all of which propose such an increase. H.R. 1053, which proposes to raise the tax to 24 cents, although less desirable, would be an improvement.

ASIM would welcome the opportunity to work with Congress in seeking the passage of these proposals, and would be pleased to answer any questions on these recommendations.

/srl

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ENDNOTES

[1] "Hidden Costs of Smoking Told in Study," American Medical News, April 13, 1984, pg. 29.

[2] Ibid.

[3] Kenneth E. Warner, "The Economics of Smoking: Dollars and Sense," New York State Journal of Medicine, December 1983, pp. 1273-4.

[4] Ibid.

[5] Figures from the Office of Tax Analysis, the Office of the Secretary, and the Department of the Treasury.

[6] Congressional Budget Office, Reducing the Deficit: Spending and Revenue Options--A Report to the Senate and House Committees on the Budget, Part III, February 1984, pg. 57.

[7] U.S. Department of Agriculture, Tobacco Outlook and Situation Report, December 1983.

[8] Kenneth E. Warner, "Cigarette Taxation: Doing Good by Doing Well," Journal of Public Health Policy, September 1984, pg. 312.

[9] J.E. Harris, "Increasing the Federal Excise Tax on Cigarettes," Journal of Health Economics, January 1982, pp 117-20.

[10] Ibid.

[11] Kenneth E. Warner, "Cigarette Taxation: Doing Good by Doing Well," Journal of Public Health Policy, September 1984, pg. 317.

/srl
I-8560

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General Counsel

Statement on behalf of the Asian Pacific American Chamber of Commerce (APACC) to be submitted for the record re:U.S. Senate Finance Committee hearing on September 10, 1985.

Dear Senators Packwood and Chaffee:

Whereas, cigarette smokers already pay more than their fair share of taxes on the federal, state and local levels, and

Whereas, cigarette taxation should, in our view, be the purview of states and not the federal government, and

Whereas, Congress in 1982 made a promise to the American people who produce, sell and enjoy tobacco products that the temporary doubling of the federal cigarette excise tax be allowed to "sunset" on September 30, 1985, and

Whereas, many of the more than 3,000 businesses who comprise the Asian Pacific American Chamber of Commerce (APACC) include convenience stores, groceries, restaurants and other small businesses that rely on cigarette sales to be profitable, and

Whereas, not allowing the federal cigarette excise tax to sunset would do little if any to reduce the nation's $220 billion budget deficit projected for 1986, and

Whereas, the average state tax on cigarettes has risen from $0.03 to almost $0.16-a-pack since 1951, when the original $0.08 rate was imposed, and

Whereas, in 1984, all governments-- federal, state and local collected $10.4 billion in cigarette tax revenues, 567 percent increase over that which was collected in 1951 , and

Whereas, one segment of society should not be singled out to bear the burden of excessive government spending deficits, and

BE IT RESOLVED that the Asian Pacific American Chamber of Commerce believes that Congress should allow the $0.16 federal cigarette excise tax to sunset back to its former $0.08 per pack rate on September 30, 1985.

Benjamin G. Maynigo
Executive Director

BOWLING PROPRIETORS' ASSOCIATION of PENNSYLVANIA
229 State Street, Harrisburg, PA 17101 - 717-234-2923

TO: The Senate Finance Committee Subcommittee on Taxation and Debt Management

The Bowling Proprieters' Association of Pennsylvania goes on record as supporting the sunset of the federal cigarette tax September 30.

The Bowling Proprieters' Association of Pennsylvania views the cigarette exise taxes as an unjust burden on lower and middle consumers and the elderly poor. Tobacco taxes are extremely regressive. These taxes are inequitable, placing a disproportionate financial burden on Hispanics, Blacks and other minorities. Thus, The Bowling Proprieters' Association of Pennsylvania strongly urges the Senate Finance Committee Subcommittee on Taxation and Debt Management to consider other fairer and more equitable means of raising revenue instead of the cigarette exise tax.

Comments of the Bakery, Confectionery & Tobacco Workers International Union

John DeConcini
International President

For Senate Finance Committee
Subcommittee on Taxation and Debt Management
"Hearing on Expiring Cigarette Excise Tax Provisions"

September 10, 1985

Submitted to:
Ms. Betty Scott-Boom
Committee on Finance
Dirksen Senate Office Building
Room 219
Washington, D.C. 20510

I am writing on behalf of the officers and members of the Bakery, Confectionery and Tobacco Workers International Union of the AFL-CIO. As Congress debates tax reform and revenue measures for 1986, we would like to express our union's concerns about the role of excise taxes in the federal tax system.

BC&T represents 150,000 workers in the food and tobacco industries in the United States and Canada, with 23,000 of its members working directly in the tobacco industry. For obvious reasons, we oppose the cigarette excise and any taxes which may destroy or diminish employment for our members. However, we believe the excise tax question goes beyond the simple interests of one industry or group of workers.

Consumption taxes in general and the cigarette excise in particular are unfair taxes. They are regressive, placing a heavier burden on people with the least ability to pay, namely, working people and the poor. For example, a recent Consumer Expenditure Study published by the Bureau of Labor Statistics shows that, in 1980, households in the bottom 20 percent of income distribution spent approximately $92 a year on tobacco products, or about 2.4 percent of total household income. On the other hand, the richest 20 percent of households spent less than one-half of one percent of their income on tobacco. The federal excise tax burden is six times greater for households in the bottom 20 percent than for households in the top 20 percent.

Data from the same report indicates that households headed by persons 65 or older paid two-and-one-half times the amount of cigarette tax paid by the richest 20 percent of all households.

And as share of total income, households with a single parent and at least one child under the age of eighteen paid at least three times the amount of tax paid by the richest 20 percent.

Proponents of income tax reform all vow to make our current tax system more fair for taxpayers at every income level. Their approach is to be applauded; however, we believe that in seeking fairness, legislators must look beyond the income tax to other forms of federal taxation, including excises. Equity for the tax system will not be achieved without careful consideration of all taxes. Indeed, many estimate that much of the fairness gained by our progressive income tax code is lost through the imposition of regressive excises. Because of their regressivity, we believe excise taxes should be reduced in the short-run and abolished in the long-run.

BC&T also is very concerned about proposals to earmark all or portions of excise tax revenues to fund specific programs. Again, federal programs should be paid for through fair and progressive taxes based on the ability to pay. For example, our union opposes the recent action by the House Ways & Means Committee to extend and earmark a portion of the cigarette excise to the tobacco price support program. Using a regressive tax to transfer income from low- and middle-income persons to farmers is unfair. Furthermore, the tax does nothing to address the real problem of tobacco growers, which is competition from foreign producers.

Other proposals call for increasing the cigarette excise and earmarking the extra revenue to Medicare and similar social programs. Advocates of this argument contend that cigarette smokers place a disproportionate burden on these programs, so an increased excise on cigarettes can be justified as a "user fee." While we agree that user fees are appropriate for some government services which benefit a very limited group of users, our nation's social safety net does not fit this category. Medicare was intended by a compassionate Congress and society to aid those in need, regardless of the cause of their illness. Besides, if the Congress is to begin imposing "user fees" on products which may be related to disease, illness, or injury, then why not tax meat, pork, eggs, petrochemicals, pesticides, autos, and motorcycles in the same manner?

Furthermore, excise taxes do not provide stable funding for fast growing programs such as Medicare. With increases in federal excises on alcohol and tobacco, for example, revenues from these sources have remained relatively flat or increased only slightly over time. In theory, with substantially large increases, it is conceivable that revenues might even drop. We believe it would be unconscionable to finance one of our nation's most important social programs with such unstable revenues.

It should also be noted that because of regressivity, excise tax funding for healthcare would unfairly place the burden of cost on the very income groups intended to benefit most from the programs.

The various proposals for earmarking signal the continuation of a dangerous trend. Congress should not be turning to regressive excises and other consumption taxes to generate new revenues. While the current budget deficit may make them difficult to avoid, Congress must focus on methods of taxation that will meet the ability-to-pay principle and generate reliable sources of revenue. Now is the time to examine and reform all federal taxes.

Testimony of Citizens for Tax Justice
before the Senate Finance Committee
concerning the Federal Tax on Cigarettes

September 9, 1985

In the midst of all of the difficult legislative and political choices that the Congress must make this fall, the debate over the federal tax on cigarettes seems, on the face of it, like a breather. After all, what's easier than raising a sin tax? If there's a way that we can cut both the deficit and cigarette consumption in one fell swoop, then what are we waiting for?

Yet the decision to extend the 16 cent per pack tax on cigarettes is much more difficult than the analysis above would suggest. This issue goes to the heart of the debate about how government revenues should be raised and what the proper goals of a tax system ought to be.

One rationale for extending or raising the federal tax on cigarettes is the need to reduce the deficit.

And each 8 cents per pack increase that is tacked onto the current federal cigarette tax brings in an additional $2 billion in badly needed revenue.

But is this really the way we want to go about reducing the federal deficit?

Taxes on consumption are unfair. The reason is simple: as family income falls, the share of income which is consumed rather than saved rises. The federal cigarette tax is borne by the consumers of cigarettes, and is a perfect illustration of how regressive consumption taxes can be.

The federal cigarette tax is one which is paid disproportionately by the poor, minorities and the elderly.

The data on this point from the most recent Consumer Expenditure Survey, published by the Bureau of Labor Statistics, show that:

-- As a share of household income, the federal cigarette tax burden is 6 times greater for households in the bottom 20 percent than for the households in the top 20 percent.

-- As a share of total income, households headed by persons 65 or older pay 2 1/2 times the amount of cigarette taxes that the richest 20% of all households pay.

-- As a share of total income, households with a single parent and at least one child under the age of eighteen pay three times the amount of cigarette taxers that the richest 20% of all households pay.

In 1965, in recognition of the fundamental unfairness of most excise taxes, Congress repealed excise taxes on 35 different products. Of the excise taxes which remain, the cigarette tax is the most regressive of a regressive lot.

The principle that tax burdens ought to be distributed according to the ability to pay has traditionally been the driving force behind federal tax policy. Over the past seventy years, progressivity in our federal trax system has been a key vehicle for enlarging and equalizing opportunity for all American citizens.

Yet much of our current deficit can be traced to the erosion of the ability to pay principle. The 1981 tax act did away with much of the federal corporate income tax and provided the wealthiest of America's families -- those with incomes of more than $200,000 a year -- with tax cuts averaging $30,000 annually.

Fifty of the nation's largest and most profitable corporations failed to pay a dime of federal income tax between 1981 and 1984, despite earning combined domestic profits of $57 billion. And more than 3,000 individuals who made in excess of $1 million paid 5% or less of their incomes in federal taxes.

The deficit is a problem that demands swift corrective action. But the answer lies in a resurrection of the ability to pay principle, not in a tax that hits the poor the hardest.

Another rationale for higher cigarette taxes is the desire to reduce cigarette smoking. But is the tax system really the best instrument for achieving this goal of social policy?

We think that the tax system that works best is one which is neutral between different types of investment and different types of consumption. Indeed, the goal of neutrality is one of the principal forces behind the current drive for large-scale tax reform.

Nearly all of the available evidence suggests that the demand for cigarettes doesn't vary appreciably with increases in price, with the exception of first-time teenage smokers.

Using this policy tool as a means to affect the behavior of this small subset of all smokers seems to us to be particularly inefficient. It might be prepared to using a meat axe when a scalpel would do. Preferable options might include increasing the funding for programs designed to educate children to the hazards of smoking, or increased regulation of cigarette advertising.

As a general rule, the tax system is a horribly inefficient tool for changing personal behavior.

Finally, some have proposed earmarking the revenue from higher cigarette taxes to special funds in order to compensate society for the extra health costs imposed by cigarette smokers. Earmarking, of course, reduces the flexibility of legislators to choose among spending priorities. And it represents a slippery slope, since any number of excise taxes could be dreamt up to fund socially desirable projects. Why not, for instance, place a tax on soft drinks to fund research on tooth decay?

The essential question is this: do we wish to tax people according to the ability-to-pay, or according to the extent to which they benefit personally from government services? Benefit taxes can have a certain theoretical attraction at times -- when the consumption of public services is non-rival (that is, when citizens who are not willing to pay for a given service can be easily excluded from enjoying the benefit of that service), when costs are readily known, and when the linkage between the tax and the service provided is clear and widely understood. The federal gasoline tax, which is earmarked for highway construction, may fall into this category.

But we feel that the federal tax on cigarettes fails to meet the criteria of what constitutes an acceptable benefit tax. And it is plagued by the very same problem that all benefit taxes are plagued with -- it ignores ability-to-pay considerations.

For us, that is the fatal flaw of this tax and just about all consumption taxes. A broad-based value-added tax, for instance, would be strikingly unfair in its impact. According to the Treasury Department, a 10% value-added tax would impose new taxes on a family making less than $10,000 a year equal to 14.2% of income. A family earning in excess of $200,000 a year would feel a new tax bite equal to only 1.8% of income.

We at Citizens for Tax Justice urge the Senate Finance Committee to let the temporary increase in the federal cigarette tax expire on schedule. We feel that it is flawed as a deficit reduction device, as a social policy tool, and as a benefit tax.

We urge this Committee to reject moves in the direction of general or selective consumption taxes and, instead, to move swiftly toward the goal of a fairer, broader income tax.

EXPENDITURES ON TOBACCO PRODUCTS AND SMOKING SUPPLIES AS A PERCENT OF HOUSEHOLD INCOME BY INCOME GROUP, 1980-81

	Average Annual Expenditures	As a percent of Household Income
Lowest 20 percent	$ 91.52	2.35%
Second 20 percent	136.24	1.38%
Third 20 percent	192.92	1.16%
Fourth 20 percent	190.32	0.77%
Highest 20 percent	175.76	0.41%
All consumer units	148.20	0.95%

EXPENDITURES ON TOBACCO PRODUCTS AND SMOKING SUPPLIES AS A PERCENT OF HOUSEHOLD INCOME BY HOUSEHOLD CHARACTERISTIC, 1980-81

	Average Annual Expenditures	As a percent of Household Income
All Consumer Units	$148.20	0.95%
One parent at least one child under 18	117.52	1.24%
Six or more persons	192.40	0.98%
Householder, 65 or over	78.52	1.02%
Lives in Northeast U.S.	150.80	1.06%
Lives in North Central U.S.	156.52	1.02%

Source: U.S. Department of Labor, Bureau of Labor Statistics Consumer Expenditure Survey: Diary Survey, 1980-81.

THE INCIDENCE OF A 16¢ PER PACK FEDERAL CIGARETTE TAX BY INCOME GROUP -- 1985

	Average Annual Cigarette Consumption - Number of Packs	Total Annual Federal Cigarette Tax Payment	Annual Federal Cigarette Taxes as % of Household Income
Lowest 20%	134.4	$ 21.50	0.6%
Second 20%	209.4	33.50	0.4%
Third 20%	287.6	46.01	0.3%
Fourth 20%	294.9	47.19	0.2%
Highest 20%	283.5	45.36	0.1%
All Consumer Units	228.1	36.50	0.2%

Source: Citizens for Tax Justice estimates based on data from the Bureau of Labor Statistics Consumer Expenditure Survey: Diary Survey 1980-81.

Household expenditures on tobacco products and smoking supplies were multiplied by .94 for each income group to obtain household expenditures on cigarettes only. Cigarette expenditures were then divided by the average price per pack, including all federal, state, and local taxes as of November 1, 1980 (60¢), to obtain the number of packs consumed by average households for each income quintile. The number of packs consumed annually was then multiplied by the 16¢ per pack cigarette tax rate to obtain total federal cigarette tax payments.

DISTRIBUTION OF 10% VALUE-ADDED TAX AS A PERCENTAGE OF FAMILY INCOME

	Broad-Based VAT, no special relief:	Broad-based VAT, with high credit for poor	Narrow-based VAT (no foods, drugs, energy, housing, water)
Under $10	14.2%	8.7%	8.9%
$10-15	9.2%	7.1%	5.9%
$15-20	7.5%	6.3%	4.8%
$20-30	6.1%	5.6%	4.1%
$30-50	5.0%	4.8%	3.3%
$50-100	3.9%	3.9%	2.7%
$100-200	3.0%	3.0%	2.3%
Over $200	1.8%	1.8%	1.7%

10% VAT AS A PERCENTAGE OF CURRENT INCOME TAX BURDEN:

	Broad-Based VAT, no special relief:	Broad-based VAT, with credit	Narrow-based VAT
Under $10	1014.3%	621.4%	635.7%
$10-15	287.5%	221.9%	184.4%
$15-20	163.0%	137.0%	104.3%
$20-30	98.4%	90.3%	66.1%
$30-50	64.1%	61.5%	42.3%
$50-100	41.5%	41.5%	28.7%
$100-200	22.7%	22.7%	17.4%
Over $200	8.6%	8.6%	8.1%

Source: U.S. Department of Treasury, Tax Reform for Fairness, Simplicity, and Economic Growth, Volume 3, November 1984.

COLLEGE OF AMERICAN PATHOLOGISTS /

WASHINGTON OFFICE
ALFRED S. ERCOLANO, *Director*
1101 VERMONT AVE., N.W. / SUITE 604
WASHINGTON, D.C. 20005
PHONE 202-371-6617

September 6, 1985

Honorable John Chafee
Chairman
Subcommittee on Taxation and
Debt Management
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The enclosed letter addressed to Senator Robert Packwood expresses the strong support of the College of American Pathologists for a continuation of the present excise tax of 16 cents per pack on cigarettes rather than permit such tax to drop back to 8 cents on October 1, 1985, as presently provided under current law.

It is our understanding that your Subcommittee on Taxation and Debt Management will conduct a public hearing on Tuesday, September 10, 1985 on the cigarette excise tax. We would like to request that the attached letter supporting a retention of the 16 cents tax be included in the printed record of hearings to be held on September 10, 1985.

Sincerely yours,

Herbert Derman MD

Herbert Derman, MD
President

HD/lvl

cc: Members, Senate Committee on Finance

STATE OF CONNECTICUT
DEPARTMENT OF HEALTH SERVICES

OFFICE OF COMMISSIONER

1985 SEP -6 PM 1:57

August 30, 1985

The Honorable John Chafee
U. S. Senate
Washington, D.C. 20510

Dear Senator Chafee:

I am writing to express my strong support for increasing the federal excise tax on cigarettes to 32¢ per pack. In Connecticut, during the past legislative session, the mood of the state's General Assembly was to cut taxes, not to increase them, therefore any efforts aimed on the state level for raising taxes might well be countered and discouraged. In light of this, it would be more feasible to concentrate efforts on raising the federal excise tax and allocating money for public health programs, specifically the Prevention, and Maternal and Child Health Block Grants, and at the same time, it is hoped that the increased federal tax would further discourage members of the public, especially young people, from considering smoking.

Although it is my understanding that some states have enacted or are planning to enact a state increase on the cigarette tax, with funds being appropriated for health education activities, I am less optimistic that this will be accomplished on a wide enough scale to have a strong impact nationwide with these preventive efforts. It is my belief that it would be more efficient and effective to increase the tax at the federal level, thereby guaranteeing consistency in all fifty states and subsequently benefitting a much larger portion of the population.

I thank you for allowing me to share my thoughts with you.

Very truly yours,

Doug Lloyd

Douglas S. Lloyd, M.D., M.P.H.
Commissioner

DSL/nad
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Durham, North Carolina 27706
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David M. Eddy, M.D., Ph.D.
Director

September 20, 1985

The Honorable John H. Chafee
United States Senate
Dirksen Senate Office Building
Washington, D.C. 20515

Re: S. 874

Dear Senator Chafee:

This letter is to support your legislation to increase the Federal excise tax on cigarettes and dedicate all of the additional revenue to the Federal Hospital Insurance Trust Fund. In my work with the National Institutes of Health, particularly the National Cancer Institute, the American Cancer Society and World Health Organization it has become very clear that cigarette smoking, and other uses of tobacco, are responsible for diseases that consume millions of Medicare dollars yearly.

Every effort must be made to prevent smoking or induce people to quit. In addition, it is only fair that the tax on cigarettes reflect the magnitude of the product's contribution to disease and disability in this country, and that this revenue go to offsetting these costs.

Faculty in the Center join me in supporting this legislation and request that this letter be made a part of the hearing record on S. 874.

Sincerely yours,

David M. Eddy

David M. Eddy, M.D., Ph.D.

HISPANIC NATIONAL BAR ASSOCIATION

1701 Eighteenth Street, N.W.
Fourth Floor
Washington, D.C. 20009

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Writer's Direct Address

Montgomery, McCracken,
Walker & Rhoads
Three Parkway, 20th Fl.
Philadelphia, PA 19102

(215) 563-0650

September 4, 1985

TO: The Senate Finance Committee Subcommittee
on Taxation and Debt Management

The Hispanic National Bar Association goes on record as supporting the sunset of the federal cigarette tax September 30.

The HNBA believes that cigarette excise taxes are regressive. They place an unfair burden on lower and middle consumers and the elderly poor. Hispanics, Blacks and other minorities share a disproportionate financial burden of such a tax, because they are overrepresented in lower income groups. The HNBA, therefore, strongly urges the Senate Finance Committee Subcommittee on Taxation and Debt Management to consider other fairer and more equitable means of raising revenue instead of the cigarette excise tax.

Respectfully,

Gilbert F. Casellas

Gilbert F. Casellas

GFC:kar

THE UNITED STATES HISPANIC CHAMBER OF COMMERCE

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Rick Aguilar

Missouri
Richard Barrera

New Jersey
Nelson Malave

[illegible]

Puerto Rico
[illegible]

June 24, 1985

To: Members of the House Ways and Means Committee:

The United States Hispanic Chamber of Commerce and its 200 affiliated organizations goes on record as supporting the sunset of the federal cigarette excise tax.

Cigarette excise taxes are regressive and place a disproportionate burden on low and middle income consumers, many of whom are Hispanic. Excise taxes on tobacco have a minimal impact on the federal deficit and hurt the general economy, resulting in reduced sales and the loss of thousands of jobs--a further detriment to the Hispanic community.

We believe Congress should keep its promise to the American people and allow this tax to sunset. Such action will be in keeping with this administration's plan to reduce taxes and promote a sound climate for our medium and small businesses.

Sincerel,

Hector Barreto
President

HB:eag

829 Southwest Boulevard Kansas City, Missouri 64108 816-842-22[illegible]

ICBO

TO: The Senate Finance Committee Subcommittee on Taxation and Debt Management

The Interracial Council For Business Opportunity goes on record as supporting the sunset of the federal cigarette tax September 30.

The Interracial Council For Business Opportunity believes that cigarette excise taxes are regressive. Such taxes place an unfair burden on lower and middle consumers and the elderly poor. Hispanics, Blacks and other minorities share a disproportionate financial burden of such a tax, because they are overrepresented in lower income groups. The Interracial Council For Business Opportunity, therefore, strongly urges the Senate Finance Committee Subcommittee on Taxation and Debt Management to consider other fairer and more equitable means of raising revenue instead of the cigarette excise tax.

INTERRACIAL COUNCIL FOR BUSINESS OPPORTUNITY
800 Second Avenue Suite 307 New York, N.Y. 10017 (212) 599-0677

State of Louisiana
DEPARTMENT OF HEALTH AND HUMAN RESOURCES
OFFICE OF PREVENTIVE AND PUBLIC HEALTH SERVICES
P. O. BOX 60630 - PHONE - 504/568-5050
NEW ORLEANS, LOUISIANA 70160
COMMISSION ON PERINATAL CARE
1525 Fairfield Ave., Rm. 505
Shreveport, LA 71130
(318) 226-7448

EDWIN W. EDWARDS
GOVERNOR

SANDRA ROBINSON, M.D., M.P.H.
SECRETARY
STATE HEALTH OFFICER
504/342-8711

1985 SEP -6 AM 10:07

September 3, 1985

The Honorable John Chafee, Chairman
Senate Finance Committee
Subcommittee on Taxation and Debt Management
United States Senate
Washington, D.C. 20510

Dear Senator Chafee:

REGARDING: S. 874

On behalf of the Louisiana Perinatal Association, I am urging you to vote to increase the cigarette tax to 32¢ per pack, but further urge that the extra 16¢ be placed in the Maternal and Child Health Program to assist with smoking cessation education programs, prenatal care, and care for low birth weight infants. It has been scientifically proven that smoking is a significant factor in the low birth weight infant. Much can and should be done to educate our citizens of the grave dangers associated with pregnancy and smoking and the harmful effects on the fetus.

I hope that this letter might be included in the hearing record to further underscore the global interest in issues such as this.

With best wishes

Sincerely yours,

Susan Berry

Susan Balser Berry, R.N., B.S.
Administrator, Louisiana Commission on
Perinatal Care
Legislative Chairman, Louisiana Perinatal Association

SBB:mes

cc Senator J. Bennett Johnston
Senator Russell B. Long

"AN EQUAL OPPORTUNITY EMPLOYER"

LUMMI INDIAN BUSINESS COUNCIL
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Councilman
VERNON A. LANE
Councilman

September 6, 1985

Senate Committee Subcommittee
on Taxation and Debt Management
c/o Ms. Betty Scott-Broom
Committee on Finance
Washington D.C. 20510

Dear Subcommitee Members:

The Lummi Indian Tribe desires to go on record as supporting the sunset of the federal cigarette tax September 30.

The available evidence shows that cigarette excist taxes are regressive, placing a disproportionate share of the tax burden on our elderly and lower income citizens. The Lummi Tribe is concerned about such tax impacts because a disproportionate share of Native Americans are in lower income groups. The Lummi Tribe strongly urges the Senate Finance Committee subcommittee on Taxation and Debt Management to consider means toehr than the unequitable cigarette excise tax to raise revenue.

Respectfully,

William E Jones
William E. Jones
Vice Chairman
LUMMI INDIAN BUSINESS COUNCIL

WEJ:MR:ah

LUMMI INDIAN BUSINESS COUNCIL
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Councilman

September 6, 1985

Senator John Chaffee
SD 567 Dirksen Senate Office Building
Washington D.C. 20510

Dear Senator Chaffee:

I respectfully request that the attached statement from the Lummi Indian Business Council be submitted and included in the printed record of the Senate Finance Committee's Subcommittee on Taxation and Debt Management hearing scheculed to take place on Tuesday, September 10, 1985.

Respectfully,

William E. Jones

William E. Jones
Vice Chairman
LUMMI INDIAN BUSINESS COUNCIL

WEJ:MR:ah
Enclosure

c.c. Senator Robert Dole
✓c.c. Senator Robert Packwood

Comments on the Cigarette Excise Tax
Prepared for the Subcommittee on Taxation and Debt
Management of the Senate Finance Committee
September 10, 1985
by Arthur Mead
Professor of Economics
University of Rhode Island

I appreciate the opportunity to submit the following comments regarding the merits of allowing the current cigarette excise to sunset as scheduled on September 30, 1985. I do so at the request of The Tobacco Institute as an economist who has done extensive research on numerous aspects of government finance.

The issue of tax reform has been, and will continue to be a subject of much debate in Washington, around the nation, and around the world. One aspect of the debate that has recently received a considerable amount of attention is the concept of fairness and efficiency in tax policy. Much has been written about making the system more fair and efficient and I will focus my brief discussion of the cigarette excise tax on these same two criteria.

Proponents of income tax reform, including Congressmen Gephardt and Kemp, Senators Kasten and Bradley, President Reagan, and others, all vow to make our current tax system simpler and more equitable. Their approach is laudable and a step in the right direction. I submit that in seeking fairness, however, we must look beyond the income tax to other forms of federal taxation, including the cigarette excise. Equity for the tax system cannot be achieved without careful consideration of the impact of all taxes.

The concept of fairness has always been associated with progressivity or a taxpayer's "ability-to-pay." A progressive tax is considered fair because the tax burden increases as income increases. An excise tax, in contrast, takes a smaller percentage of income as income increases and, therefore, fails the ability-to-pay criterion of fairness. It is regressive, placing a larger tax burden on low-income families. Indeed, much of the fairness gained by our progressive income tax code can be lost through the imposition of a variety of regressive taxes including excises.

A preliminary measure of the regressive nature of the cigarette tax can be obtained from a recent study by East Carolina University economist V. Glenn Chappell. He calculates the effective tax rate for cigarette consumers in the $30,000 and above category to be .12 percent while the effective rate for consumers with incomes of $5,000 or less is .88 percent. The tobacco tax burden for the lower-income consumer is more than seven times larger than that of the higher income individual. Stated somewhat differently, a person who earns less than $5,000 per year will have to work two complete days more to pay his or her cigarette excise taxes than an individual earning $30,000 per year. For Blacks with incomes of $5,000 or less, the burden of cigarette excise taxes is ten times higher than that of the $30,000 and above income group (see Table 1).

Consider too, the demographic characteristics of cigarette smokers. They tend to be slightly younger and less educated than their non-smoking counterparts. They also are concentrated in low-income occupations. Other data published by the Journal of Occupational Medicine, suggests that persons working in occupations traditionally classified as blue-collar are affected by the cigarette tax because they are much more likely to be smokers than persons working in occupations classified as white-collar and professional (see Tables 2 and 3). The cigarette excise tax burden then, is both proportionately and absolutely heavier on lower-income families.

In addition to being unfair, the cigarette excise is economically inefficient. I'm sure Members of the Subcommittee will agree with me that taxes should not destroy any more wealth than is necessary to achieve a given revenue target. But generally accepted estimates on the economic waste inherent in excises are high -- two to three times higher than estimates for income taxes. This is because excise taxes clearly cause a product's price to rise and while much of the tax is passed onto the consumer, a significant portion is paid by the producer. The relative share of each burden depends on each group's responsiveness to the change in price of the taxed good.

For cigarettes, consumers are the relatively less responsive group, meaning they bear the largest share of the excise burden. But resources used to produce the good will shift to other activities that are not taxed; production will be reduced and jobs will be lost. This means the opportunity cost of a pack of cigarettes is lower than its value as determined by consumers. Such a wedge between cost and price produces an inefficiency that economists call a deadweight cost; the total losses of consumers and producers exceeds revenues gained by the taxing authority. The potential gains from mutually beneficial transactions between consumers and producers are lost forever. That is, excise taxes represent a permanent loss of welfare.

Excise taxes contradict the philosophy that the marketplace, not the government, should determine the allocation of resources in the economy. If Congress believes that a good tax is one that interferes least with the incentives of the market system, then excises should abolished.

Yes, Congress must cut the budget deficit -- and soon. To do this, it will have to find new and reliable sources of revenue and better ways to tap existing revenue sources. I believe that by modifying the income tax code to eliminate loopholes, and by carefully cutting excesses from the federal budget, the deficit can be reduced. It is time to move away from antiquated, inequitable, and unproductive excises as major sources of tax revenue. The cigarette tax should be allowed to sunset as scheduled and increases in this and other excises should be avoided in the future.

TABLE 1

Tobacco Taxes As a Percentage of Money Income-Before Taxes of Urban Consumer Units and Black Urban Consumer Units

Income Class	All Urban Consumer Units	Black Urban Consumer Units
Less than $5,000	0.88	1.20
$5,000 - $9,999	0.47	0.60
$10,000 - $14,999	0.37	0.50
$15,000 - $19,999	0.28	0.40
$20,000 - $29,999	0.22	0.30
$30,000 and over	0.12	0.20

Source: V. Glenn Chappell, The Burden of Tobacco Taxes by Income Class, 1985

TABLE 2

Percentage Male Smokers by Detailed Occupational Category

Category	Percentage Smokers
Garage Laborers	58.5
Cooks (Not Private Household)	57.5
Maintenance Painters	56.3
Pressman and Plateprinters	55.7
Auto Mechanics	54.6
Assemblers	52.7
Shipping and Receiving Clerks	50.0
Personnel, Labor Relations	36.9
Draftsmen	34.2
Accountants and Auditors	33.3
Lawyers	30.3
Engineers, Aeronautical	26.2
Engineers, Electrical	20.3

Source: Sterling, T., and Weinkam, J., "Smoking Characteristics by Type of Employment," Journal of Occupational Medicine, 18 (11), 1976, pp. 743-754.

TABLE 3

Percentage Female Smokers of Detailed Occupational Category

Category	Percentage Smokers
Waitresses	49.6
Shipping and Receiving Clerks	48.5
Assemblers	43.6
Bookkeepers	38.6
Nurses, Professional	38.4
Laundry and Drycleaning Operative	38.3
Secretaries	37.3
Accountants and Auditors	30.8
Stenographers	28.4
Technicians, Medical and Dental	23.6
Elementary School Teachers	19.4
Librarians	16.4

Source: See Table 2

NATIONAL ASSOCIATION FOR THE ADVANCEMENT OF COLORED PEOPLE
186 REMSEN STREET • BROOKLYN, NEW YORK C11202-9114 • (718) 858-0800

BENJAMIN L. HOOKS
Executive Director

August 28, 1985

The Honorable Robert Packwood
Senate Finance Committee
Dirksen Senate Office Building
Constitution Avenue, N.E.
Washington, D. C. 20510

Dear Senator Packwood:

The National Association for the Advancement of Colored People supports tax reforms that do not shift the tax burden in ways that enable the wealthy to escape paying their fair share of taxes. We support reforms that ease the disparate burden on low-and-middle income taxpayers.

The NAACP supports a tax reform policy that will modify or replace the regressive excise tax which has a disproportionate impact on low-income consumers and urges the Committee to support legislation to reduce the tax burden on this taxpayer category.

I respectfully request that the above be included in the printed record of the Senate Finance Committee's Subcommittee on Taxation and Debt Management, scheduled to take place on Tuesday, September 10, 1985.

Sincerely,

Benjamin L. Hooks
Executive Director

BLH:bh

cc: Robert Dole

NABCO

National Association of Black County Officials
P.O. Box 1968, Santa Ana, CA 92702
(714) 834-2734

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John H. Stroger, Jr.

September 5, 1985

Members of the Senate and Subcommittee on Taxation and Debt Management

The National Association of Black County Officials goes on record as supporting the sunset of the federal cigarette tax September 30.

This excise tax is regressive and places unfair burden on lower and middle income smokers in general, and on Blacks and other minorities in particular.

We hope that Congress will keep its promise to the American people and allow this tax to sunset. If cigarette taxes should be raised at all, we believe that issue should be left to the states and local governments in need of this revenue. That approach would be more in keeping with the administration's plan to reduce taxes and return more revenue raising responsibilities to the states and local governments.

NABCO asks that you consider the thrust of the financial impact of this tax during your hearings.

Sincerely,

Webster J. Guillory
President

WJG:bl

WASHINGTON OFFICE • 440 First Street N.W., Suite 500A • Washington, D.C. 20001 • (202) 347-6953

**NATIONAL
ASSOCIATION OF
BLACK & MINORITY
CHAMBERS OF
COMMERCE**

August 28, 1985

TO: The Senate Finance Committee Subcommittee on Taxation
and Debt Management

The National Association of Black and Minority Chamber of Commerce (NABMCC) would like to go on record in support of the sunset of the federal cigarette tax September 30, 1985.

NABMCC believes that cigarette excise taxes do not result in reduced smoking, they only reduce the income of the poor. Such taxes thusly, place an unfair burden on lower and middle income consumers and the elderly poor. Hispanics, Blacks and other minorities share a desproportionate financial burden of such a tax, because they are overrepresented in lower income groups.

NABMCC, therefore, strongly urges the Senate Finance Committee Subcommittee on Taxation and Debt Manaement to consider the negative impact of this legislative proposal on poor and minority consumers of tabacco, and consider other fairer and more equitable means of raising revenue instead of the cigarette excise tax.

Sincerely,

Oscar J. Coffey, Jr.
President

OJC:jew

7700 Edgewater Dr. • Suite 742 • Oakland, CA 94621 • (415) 639-7915
A Department of Commerce, Minority Business Development Agency funded project.

NAMC NATIONAL ASSOCIATION OF MINORITY CONTRACTORS
1250 EYE STREET, N.W. SUITE 505 WASHINGTON, D.C. 20005 (202) 347-8259

The National Association of Minority Contractors was established in 1969 to address the business needs of minority construction contractors, in addition to assist in improving the quality of life in the community that our members are located.

Therefore, the National Association of Minority Contractors goes on record as supporting the sunset of the federal cigarette tax on September 30, 1985.

We believe that excise taxes are regressive and place an unfair burden on lower and middle income smokers in general, and on Blacks and other minorities in particular.

We further believe that Congress should keep its promise to the American people and allow this tax to sunset. If cigarette taxes should be raised at all, we believe it should be left to the states in need of this revenue which is in keeping with this administration's plan to reduce taxes and return more revenue raising responsibilities to the states.

In addition, we feel that this projected revenue on a state level would help to create meaningful employment within the minority community.

A FULL SERVICE MEMBERSHIP CONSTRUCTION ASSOCIATION
WORKING FOR A BETTER CONSTRUCTION INDUSTRY

Dare To Dream! Take Charge! Make Dreams Come True!

MEMO

September 5, 1985

From: Frankie Jacobs Gillette, National President

To: The Senate Finance Committee Subcommittee on Taxation and Debt Management

As president of the National Association of Negro Business and Professional Women's Clubs, Inc. I would like to go on record as supporting the sunset of the federal cigarette tax September 30, 1985.

Such taxes as the cigarette excise tax place an unfair burden on lower and middle income consumers and the elderly poor.

Black women and men, as well as Hispanics, Asians, and other minorities share a disproportionate financial burden of such taxes, for they are overrepresented in lower income groups. Studies indicate that Black consumers who have low incomes pay more than one and one-third times as much tobacco tax as do all consumer units. The tobacco hikes represent a significant increase in the tax burden born by the poor.

Higher taxes don't reduce smoking, they reduce the income of the poor, who, because of unusual and unavoidable stress, tend to smoke more.

I urge the Senate Finance Committee Subcommittee on Taxation and Debt Management to consider other fairer and more equitable means of raising revenue. Please sunset the federal cigarette tax.

Thank you.

F. J. Gillette

National Association of Negro Business and Professional Women's Clubs, Inc.

Office of the President • 890 Hayes Street • San Francisco, California 94117 • (415) 621-4391
Residence • 85 Cleary Court • San Francisco, California 94109 • (415) 563-8299

THE NATIONAL BLACK CAUCUS OF STATE LEGISLATORS

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TESTIMONY OF CLARENCE M. MITCHELL, III
FOR THE SENATE FINANCE SUBCOMMITTEE
ON TAXATION AND DEBT MANAGEMENT
SEPTEMBER 10, 1985

I am Clarence M. Mitchell, III, state senator from Maryland, and president of the National Black Caucus of State Legislators. I appreciate the opportunity to have my written testimony on extension of the temporary increase in the cigarette excise tax included in the Committee's record.

I represent an organization made up of 388 black state legislators in 42 states with a collective constituency in excess of 26 million people. We operate at the grass-roots level, and we formed as a caucus because we felt the larger body, the National Conference of State Legislatures, was not addressing some of the specific issues peculiar to our legislators and constituents.

We found that there was a need for some vehicle to give special attention to those issues that concern black Americans from the state perspective. We have been in existence since 1977, and we are beginning to emerge. We have an office on Capitol Hill in the Hall of the States building. You will continue hearing from us that you might have the benefit and advantage of our thinking from the state perspective on the various issues you will be considering.

"A National Network For Political Equality!"

I think it is especially important that you understand we have, across the board, taken a position that nuisance taxes or luxury taxes or those taxes which impose a heavier burden on low-income people and the poor in our society are grossly unfair.

The concept of fairness has always been synonymous with progressivity. A progressive tax is generally considered fair because it is based upon one's ability to pay -- the tax burden increases as income increases.

Excise taxes, however, are not progressive. Indeed, they are regressive -- actually taking a smaller percentage of income as income increases and, therefore, placing a larger tax burden on working families and the poor rather than the rich. What little fairness an individual gains from our progressive income tax code, is often cancelled out by the regressive excise taxes levied by the local, state and federal governments.

Tobacco taxes, liquor taxes, sales taxes are not fair. They are regressive and they hurt people who in the past, to a large extent, had not been heard from. They were unorganized and they were on the avenue of least resistance. They didn't raise the hue and cry that comes from the more affluent in our society.

Excise taxes were originally intended to be luxury taxes on the wealthy. However, that has long since ceased to be the case. For example, the excise taxes on jewelry and furs, which are true luxury items, were repealed in 1965. The federal excise taxes which remain are levied primarily on items with inelastic demand. These items, including telephone service, gasoline and automobile tires, in addition to cigarettes, are used by all income groups everyday.

I would most respectfully submit that those of us who would promote and support these kinds of taxes do a great disservice to the title that we hold as public servants, especially in light of the fact that I have always viewed my position as one of public trust, imposing upon me a responsibility to pass legislation and tax proposals that are fair.

That the burden of these taxes falls most heavily on the poor is no more evident than with the cigarette excise tax. In fact, this tax is regressive in the extreme. The effective tax rate on individuals in lower tax brackets is ten times as high as that paid by individuals who earn in excess of $50,000 annually.

The unfairness of the cigarette tax is compounded by the fact that a significantly higher proportion of lower income individuals smoke than persons earning higher incomes. Survey data from the National Center for Health Statistics reveal that persons earning $7,000 or less are 50 percent more likely to be smokers than persons earning $25,000 or more. (See Chart 1). In each age group except the elderly, the percentage of smokers as a proportion of the total group declines as income increases. Clearly, lower income persons in most age brackets are hardest hit by cigarette excise taxes.

The unfairness of the cigarette tax is even more evident when smoking among occupational groups is examined. Several studies indicate that persons working in occupations traditionally classified as blue-collar are more affected by the cigarette tax because they are much more likely to be smokers than persons working in occupations classified as white-collar and professional. (See Charts 2 and 3). For example, garage laborers, cooks and pressmen are twice as likely to smoke as lawyers. Again, it is clear that low- and moderate-income individuals generally working in blue-collar jobs are hardest hit by the cigarette tax.

Finally, survey data also show that among workers, Blacks are more likely to smoke than their white counterparts. For example, approximately 51 percent of all Black male workers smoke while only 43 percent of all white male workers do so. Similarly, among blue-collar workers, Blacks are more likely to smoke than whites. Approximately 60 percent of Black males smoke, but only 54 percent of their white counterparts do. Black consumers in the lowest income category bear a tobacco tax burden that is more than one and-one-third times greater than the burden on the lowest income category for all consumer units. Within the Black community the tobacco tax impact is also extremely regressive with the tax burden on the lowest income category six times greater than that imposed on the highest income category.

The analysis seems to indicate that taxes on tobacco products are levied at higher effective rates on the poor than they are on the rich. This is evident in both the Black consumer and the overall consumer market. It is apparent that the 1982 doubling of the federal cigarette excise tax and increases in some 30 state cigarette taxes have worsened the situation since 1981. Despite all the tax cuts in recent years, the tobacco hikes represent a significant increase in the tax burden born by the poor.

All studies indicate that price increases do not affect cigarette purchases very much. In other words, higher taxes don't reduce smoking, they only reduce the income of the poor. Clearly, the cigarette tax creates an unfair burden on blacks and other minorities.

If we suggest a fair tax, like a properly graduated income tax, if we were to impose a fair tax, then today we would not be talking about the budgetary deficits that are doing such damage to our economy. But many of us, and I include myself as a public official, have failed to live up to our responsibility to give leadership in this area and demonstrate to all of the people we represent that government can be responsive and can be fair.

As we talk about this particular tobacco tax and allowing the sunset to occur in October, there are some states which already are passing legislation to make up for the difference in anticipating that the Congress will not do damage to the sunset, and therefore they can pick up the revenues that would come from the difference between their state taxes and the federal tax. So, certainly state legislators are as guilty as members of Congress in this respect.

I think it is also important that you understand that by the passage, by allowing the sunset provisions to take place, you send a message at a time that you are considering a tax proposal that is unfair. It is titled a Tax Reform Act.

In fact, I chair the Joint Federal Relations Committee in the Maryland Legislature. We just spent all of Tuesday, June 11, 1985 hearing about this great tax reform proposal that you are considering now, and find that seven states that do not impose income taxes also happen to be some of the richest states, the oil states. They would not be affected if this tax proposal were to pass, certainly not affected as the residents of Maryland and other states with income taxes. By eliminating the state income tax deduction from federal income taxes, my constituents as well as millions of other taxpayers will be paying higher federal taxes. This is surely an unfair element in a reform package.

And I suggest that there comes a time when we have to begin sending some different messages; and I would hope that this committee would see fit to reject the effort to prevent the reduction in the tobacco taxes.

It has been said over and over that you can't tax people into doing what you want them to do. If we proceed along that line, then we will be taxing cities which have more pollution than other cities, and we will be taxing all of those items and elements in our society that pose high risks to the people we represent. I suggest that that is an improper way to move.

In conclusion, to reform the federal income tax while leaving in place an archaic, regressive levy like the cigarette excise tax is bad public policy. We should not rely on this unfair method of taxation to provide government services since it is doing so at the expense of working families and the poor who already carry more than their fair share of America's tax burden. I urge the Committee to maintain the October 1 sunset on the cigarette excise tax.

/////

CHART 1

PERCENTAGE OF SMOKERS BY INCOME*

Age Group	Less than $7,000	$ 7,001- $14,999	$15,000- $24,999	$25,000+
17-19	30.1%	27.9%	23.0%	17.2%
20-24	37.8	40.8	30.5	33.4
25-34	45.9	41.9	36.3	29.0
35-44	51.4	41.8	37.2	35.0
45-65	40.1	38.8	35.8	31.0
65+	17.4	18.0	15.6	18.2

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*Unpublished data from the National Health Interview Survey, National Center for Health Statistics. Survey interviews took place during last six months of 1980.

CHART 2

PERCENTAGE MALE SMOKERS BY DETAILED OCCUPATIONAL CATEGORY

Category	Percentage Smokers
Garage Laborers	58.5
Cooks (Not Private Household)	57.5
Maintenance Painters	56.3
Pressman and Plateprinters	55.7
Auto Mechanics	54.6
Assemblers	52.7
Shipping and Receiving Clerks	50.0
Personnel, Labor Relations	36.9
Draftsmen	34.2
Accountants and Auditors	33.3
Lawyers	30.3
Engineers, Aeronautical	26.2
Engineers, Electrical	20.3

Source: Sterling, T., and Weinkam, J., "Smoking Characteristics by Type of Employment," Journal of Occupational Medicine, 18 (11), 1976, pp. 743-754.

CHART 3

PERCENTAGE FEMALE SMOKERS BY DETAILED OCCUPATIONAL CATEGORY

Category	Percentage Smokers
Waitresses	49.6
Shipping and Receiving Clerks	48.5
Assemblers	43.6
Bookkeepers	38.6
Nurses, Professional	38.4
Laundry and Drycleaning Operative	38.3
Secretaries	37.3
Accountants and Auditors	30.8
Stenographers	28.4
Technicians, Medical and Dental	23.6
Elementary School Teachers	19.4
Librarians	16.4

Source: See Chart 2

national black police association nbpa 1517 w. girard ave., philadelphia, pa. 19130 • (215) 232-3040

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TO: The Senate Finance Committee Subcommittee on Taxation
and Debt Management

The National Black Police Association goes on record as supporting the sunset of the federal cigarette tax next September 30th.

We believe that excise taxes are regressive and place an unfair burden on lower and middle income smokers in general, and on Blacks and other minorities in particular.

We further believe that Congress should keep its promise to the American people and allow this tax to sunset. If cigarette taxes should be raised at all, we believe it should be left to the states in need of this revenue, thus keeping with this administration's plan to reduce taxes and return more revenue raising responsibilities to the states.

**NCMI THE NATIONAL
COIN MACHINE INSTITUTE, INC.**
(Serving Cigarette, Music and Game Operators)
**5301 North Dixie Highway
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August 29, 1985

Senator John Chafee
Committee on Finance
Room 219 - Dirksen Office Building
Washington, D.C. 20510

Dear Senator Chafee:

My name is Norman Borkan and I am President of the National Coin Machine Institute, a trade organization of vending machine operators. Our members operate about 100,000 of the 750,000 cigarette vending machines on location in the country. I am also the Manager of the Standard Vending Service, which operates cigarettes vendors in Texas, Arizona and Colorado.

The addition of the extra 8-cent tax on cigarettes has had a disastrous effect on cigarette vending. With the resultant increase in the price of cigarettes, our unit sales dropped 33% and dollar gross declined by 21%. Since that gross includes both federal and state taxes, profits are disappearing rapidly.

Cigarettes are one of the major mainstays of vending, accounting for close to 20% of the dollar volume registered by all kinds of vending machine sales. In a battery of vendors, which would include such products as soft drinks, coffee, candy, ice cream, milk, sandwiches and hot foods, the cigarette machine is a staple item that contributes to a profitable operation, making the installation practical. If the cigarette vending machine is not making sales, the entire venture may collapse.

I would like to emphasize that cigarette vendors do not make smokers. They are merely a convenient source of supply for the smoker, who does not have to travel any distance to obtain the pack of his choice.

Based on our experience, the additional 8-cent cigarette tax has proven punitive. It has increased our cost of operation, since we had to modify the coin mechanisms on our vending machine to adjust to the new price rate that the added levy brought about.

The decline in cigarette vending sales has caused us to lay off an average 30% of our employees, since we require fewer personnel to service equipment that is not generating a proper sales level. In other words, instead of a routeman servicing a machine once a week, it now only has to be visited every two weeks and that calls for fewer workers -- adding to local unemployment.

With business bad for the cigarette machine operator, this factor has been reflected at the vendor manufacturing level. Since cigarette vending is on a downtrend, virtually no new models of equipment have been produced in the last few years. With the industry uncertain as to the tax situation, the vendor-makers have been unwilling to invest in research and development. In fact, product has declined sharply. Where 58,000 cigarette vendors were being built annually 10 years ago, the number has now declined to a yearly output of less than 11,000 new machines.

Also injured are the suppliers of cigarettes to the vending industry, particularly local wholesale tobacco distributors. As vending volume declines, so does wholesale volume, with a domino effect on local employment and national prosperity.

What's more, the reduction in cigarette sales has had a dual impact beyond the vending industry proper. First, the drop in sales has reduced the revenues available to those locations where operators place their machines. This includes a wide range of installations, from hotels and taverns to transportation facilities, as well as many industrial and institutional sites. The revenue that these locations lose from reduced vending sales commissions must be made up somehow and this results in higher costs levied on, or reduced benefits offered to, smokers and non-smokers alike.

The extra 8-cent levy has caused economic hardship. We feel that the smoker has been singled out as a sacrificial lamb and that this discriminatory taxation is being justified as the basis for social engineering.

We in vending have suffered with the additional 8-cent tax on cigarettes, but the one thing that has given us hope and kept us going was the promise of a sunset repeal. Please don't go back on that promise.

Respectfully sumbitted,

NATIONAL COIN MACHINE INSTITUTE, INC.

Norman Borkan

Norman Borkan, President

NB:cja

NATIONAL CONFERENCE OF BLACK MAYORS, INC.

STATEMENT BY MAYOR MARION BARRY ON BEHALF OF THE NATIONAL CONFERENCE OF BLACK MAYORS, INC.

Given to the

Senate Finance Committee's Subcommittee on Taxation and Debt Management

SUBJECT: CIGARETTE EXCISE TAX

I am Marion Barry, Mayor of Washington, D.C. and President of the National Conference of Black Mayors, Inc. (NCBM). As mayors, we appreciate the difficulties and complexities of generating public revenues sufficient to fulfill the responsibilities of government; obviously, we must deal with the budget process at the municipal level. This we commend the Administration, the Congress and this body, in particular, for their work in this important area, and their efforts to make our nation's tax system fairer and more rational.

I am compelled to state our organization's disagreement with proposals to extend the current 16¢ per pack excise tax on cigarettes. We feel that such actions would be unwise since there are already burdensome taxes on cigarettes and tobacco in place at the federal and state levels. Extending the tax could well have undesirable effects not only on the tobacco industry,

1430 WEST PEACHTREE STREET, N.W., SUITE 318, ATLANTA, GEORGIA 30309
TELEPHONE 404/892-0127

but on related industries such as paper products and warehousing. Another problem is that since smoking has been shown empirically to be more prevalent among low and moderate income people, they pay a disproportionate share of cigarette excise taxes, which is fundamentally unfair. Finally, enactment of short term measures such as the excise tax simply delays the process of identifying and correcting the flaws in the nation's spending priorities and inequities and redundancies in our current tax system. For these reasons, we urge that this Subcommittee not recommend the extension of the excise tax on cigarettes beyond its scheduled expiration date of September 30, 1985.

Statement of
Edwin Sutton, President
National Farmers Organization of Kentucky
Route 2, Crab Orchard, Kentucky 40419

before the

Subcommittee on Taxation and Debt Management
Committee on Finance
United States Senate

September 10, 1985

Mr. Chairman, Members of the Finance Committee:

My name is Edwin Sutton. I am president of the Kentucky National Farmers Organization. My two sons and I own and operate a 700 acre tobacco/livestock farm in Garrard County, Kentucky.

We are all aware of the problems facing agriculture today, all of which have been brought about by low farm prices, which coupled with high costs of production, lead to deterioration of farm assets and farm foreclosures. We on the farm, are in the worst economic crises since the depression of the early thirties. Publication of the parity ratio index recently by the U.S. Department of Agriculture established an all time low. The parity ratio reached 52 in May of this year, and this was the lowest ever. It only dropped to 53 in June of 1932.

Since I am a tobacco producer and our main cash crop in Kentucky is burley tobacco, I am pleased to be here to discuss the possibility of removing some of the excise tax on tobacco products.

In 1982, Congress added an additional tax of 8 cents per pack on cigarettes with the provision that it would expire on October 1, 1985. Following the imposition of this tax, cigarette consumption dropped 7%. While other factors contributed to the decline in cigarette consumption, I am convinced that the additional excise tax was the major factor causing the decline in cigarette consumption.

I believe this is an unfair tax. When the tax was increased in 1982, the 55 million people who choose to smoke were singled out to pay this extra burden. I think this is unequal taxation.

The large decline in cigarette consumption impacts directly on income from tobacco. It is estimated that the value of the tobacco crop declined by one billion dollars in 1983. Part of this decline was due to adverse weather, but a large part of the decline in farm income can be attributed to lower consumption of tobacco products caused by increased excise taxes.

In 1983, the 97th Congress indicated to the American people that the cigarette tax would be a temporary measure. In addition, a major theme of the 1984 presidential and congressional campaigns was opposition to a tax increase of any kind. One thing is clear--refusal to allow the cigarette tax to expire on October 1 as scheduled is a tax increase, an increase which will have a direct impact on the producers of tobacco.

During the past several months, all segments of the tobacco industry have been working together to develop a program to cope with declining demand for tobacco products, excess supplies of tobacco in storage, and a declining share of the world market for tobacco. If this tax is allowed to expire I believe the demand for our American tobacco products will increase.

In my opinion, people will continue to use tobacco in some form. Taxation will increase cost and companies will look elsewhere for cheaper tobacco to cheapen the cigarette. Our market will further decline and more farmers will have to leave the farm.

In conclusion, I think we have reached a sad time in the history of agriculture when, due to low farm prices, the high cost of production, and high taxation, we cannot pass our land on to our children because they cannot profit enough from the production off the land to meet expenses, have a comfortable living and educate their children. They cannot have the way of life we enjoyed in the past. This committee probably cannot do anything about low prices or high production costs, but you can do something about high taxation. I therefore strongly recommend that the 8¢ excise tax on a pack of cigarettes be allowed to expire on October 1, 1985.

Thank you very much for the opportunity to appear before this Committee.

National Coalition of 100 Black Women, Inc.

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[illegible] YORK N Y [illegible]

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[illegible]
SHELLEY CRUMP

The National Coalition of 100 Black Women goes on record as supporting the sunset of the federal cigarette tax next September 30.

We believe that excise taxes are regressive and place a burden on lower and middle income smokers.

Moreover, if cigarette taxes should be raised at all, it should be left to the states in need of this revenue in keeping with this administration's plan to reduce taxes and return more revenue raising responsibilities to the states.

Lastly, we urge congress to fulfill its commitment to sunset the federal cigarette tax.

August 28, 1985

TO: The Senate Finance Committee Subcommittee on Taxation
and Debt Management

The National Hispanic Council on Aging goes on record as supporting the sunset of the federal cigarette tax September 30, 1985.

The National Hispanic Council on Aging believes that cigarette excise taxes are regressive. Such taxes place an unfair burden on lower and middle consumers and the elderly poor. Hispanics, Blacks and other minorities share a disproportionate financial burden of such a tax, because they are overrepresented in lower income groups. The National Hispanic Council on Aging, therefore, strongly urges the Senate Finance Committee Subcommittee on Taxation and Debt Management to consider other fairer and more equitable means of raising revenue instead of the cigarette excise tax.

Sincerly,

Marta Sotomayor, Ph.D.
President
Board of Directors, NHCoA

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National United Affiliated Beverage Association
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NUABA'S POSITION ON THE SUNSET TAX ISSUE

The National United Affiliated Beverage Association considers cigarette excise taxes as regressive and depressive for minority Americans. Since minorities already share a disproportionate amount of the financial burdens in this country, the cigarette excise tax would create even greater hardships for minorities who are already overburdened with reductions in state programs that benefitted them. The cigarette excise tax would worsen the condition for minorities across this country. The time is now for our government to realize that unless sensitivity is given to the needs of the poor, the greeds of the rich will create disaster for our great democracy. We implore the Senate Finance Committee to use sound judgement in considering this issue. Higher taxes will create more of a dependency on smoking for the relief of added anxieties and stress. For too long, the poor has been victimized by institutional designs that preclude upward mobility. Let us move into the future with a sound tax system that does not penalize the poor.

National Urban League, Inc.

The Equal Opportunity Building
500 East 62nd Street, New York, N.Y. 10021
Telephone: (212) 310-9000

TO: SENATE FINANCE COMMITTEE

The National Urban League goes on record as expressing its deep concern over the disproportionate negative impact the federal cigarette tax has on our constituents.

Cigarette excise taxes are regressive in that consumers in all income categories pay the same amount of tax. This results in consumers with incomes under $5,000 paying a cigarette tax rate seven times greater than consumers in the $30,000-and-up income brackets.

We have consistently urged tax relief for poor people, whose overall tax rates have sharply increased in recent years. Such tax relief should also include regressive excise taxes that hurt low-income consumers. To us, the primary issue before this Committee is the issue of fairness. We believe the Committee should act to reduce the unfair tax burden on people in the lowest income groups.

:::::

Contributions to the National Urban League are tax deductible.

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James Sparrow
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Chairman, POW Activities Committee

John Holland
Co-Chairman, POW Assistance Committee

STATEMENT IN OPPOSITION TO
CONTINUATION OF EXCISE TAX INCREASE

By

J. THOMAS BURCH
NATIONAL COORDINATOR

The National Vietnam veterans Coalition is a federation of 26 separate vietnam veteran organizations throughout the country, which represents a broad spectrum of interest concerning Vietnam veterans. The Coalition has been active in Agent Orange litigation, the return of POW's and the accountability of MIA's, veterans jobs programs and more broadly the general welfare of our men and women who served in the war. The combined membership of the Coalition is approximately 200,000. Most recently we have become concerned about the efforts to restrict smoking as it effects Vietnam veterans who are predominately users of tobacco.

As a result of trauma and hardship associated with their service in a difficult and unpopular war, many soldiers came to rely on the pleasures afforded them by tobacco, and many veterans continue to practice because it helps them to cope. The majority of Vietnam veterans are now smokers; indeed they are proportionately the largest single proportionate population of smokers in America, more than double the national average.

Not only was the war a difficult one, but lamentably, it was disproportionately fought by the underprivileged and by racial minorities. This committee has already heard from representatives of black and Hispanic groups who represent some of these same constituencies which have formed such a large roll of honor within ranks of Vietnam veterans. We are here to reiterate what they have already said:

The proposed four fold increase in the cigarette tax is regressive in the extreme. It is precisely those in the lower income brackets including a large segment of the Vietnam veterans community-who will bear a disproportionate financial sacrifice.

According to the recent SBA findings reported in the Wall Street Journal on September 9, 1985, more than ten percent of Vietnam veterans aspire to own their own businesses. It is precisely the small, entrepreneurial businesses which depend the most on cigarette sales. Since the tax can be expected to result in a decrease in cigarette sales, the tax proposal once again deals a major blow to the aspiration of a large segment of the Vietnam veterans community.

This bill is not a genuine revenue raising measure. Its supporters are quite candid in saying that their aim is to restrict smoking and not to raise revenue. We believe that an individual's use of tobacco is a reasonable private choice and the taxing power should not be used as a vehicle to inhibit choice. We don't believe the power to tax should be used as the power to destroy by the United States Congress.

The committee might also wish to consider whether the punitive taxation of tobacco would drive its users to other substances whose potential for harm is far greater than any harm claimed for tobacco by its most virulent critics.

In summary, then, we regard the proposed tax increase as another in the long line of blows directed at Vietnam veterans. It unfairly penalizes them by its insensitive failure to recognize the therapeutic value of tobacco to pressured individuals by undercutting the potential of entrepreneurship as a solution for readjustment and by transferring more of the tax burden in their direction. Lastly, given the range of noxious substances which can be substituted for tobacco, the revenue measure is unlikely to even serve the real agenda of the tax increase proponents and may actually contribute to deteriorating societal health.

STATEMENT OF THE NATIONAL GRANGE
BY
JAMES R. OLIVER
MASTER, NORTH CAROLINA STATE GRANGE
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
SENATE FINANCE COMMITTEE
SEPTEMBER 10, 1985

RE: CIGARETTE EXCISE TAX

Mr. Chairman and Members of the Subcommittee:

I am Jim Oliver, a farmer, Master of the North Carolina State Grange, Officer of the National Grange, member of the Agriculture Committee of the National Grange and the National Grange Legislative Representative on tobacco issues. The National Grange represents members in 41 states with a total membership of over 400,000. Within the Grange are growers of both burley and flue-cured tobacco; therefore, we have a vital concern over the future of the tobacco industry, particularly, the financial condition of the family farmers who are the backbone of the industry.

Tobacco has been under constant attack from one source or another since it was first discovered in America by our early settlers. As a result, these attacks, combined with efforts to improve the program, have resulted in many changes taking place in the tobacco program since its inception in the early 1930's. One of the latest changes, the implementation of the no-net-cost program in 1982, has had a very devastating effect on the tobacco farmer. As you are aware, this program requires the tobacco program to operate at a no-net-cost to the government with the tobacco farmer paying, through assessments, the cost of the program. Since the implementation of the no-net-cost program and the freezing of the price support in 1983, we have seen a drastic increase in imported cigarette tobacco entering the United States. According to the March, 1985 issue of Tobacco Outlook and Situation Report, imports for consumption of cigarette tobacco has risen 159% between 1982 and 1984. General imports have risen 147% during this timeframe. These large amounts of imported tobacco together with a loss of some of our foreign markets as a result of the dollar's high value has caused the amount of tobacco in stabilization stocks to rise drastically. As a result of this, the assessments collected from flue-cured growers to finance the no-net-cost tobacco program have increased from three cents in 1982 to seven cents in 1983; seven cents in 1984 and 25¢ in 1985. Burley assessments increased from one cent to 30¢ during the same timeframe. It is quite evident that the no-net-cost program has become a no-net-profit program for the flue-cured and burley tobacco producers.

Based upon the 1985 effective quota of 764 million pounds for flue-cured, the assessment at 25¢ a pound paid by the flue-cured farmer would amount to $191 million. Based on the burley effective quota of 537 million pounds at 30¢ a pound for burley tobacco, the assessment collected from the burley growers would amount to $161.1 million. Total assessment to be collected from both burley and flue-cured growers for 1985 would amount to $352.1 million. With the implementation of new provisions to shift this cost to the end user, the tremendous financial burden now on the backs of our flue-cured and burley producers would be lifted.

Mr. Chairman, I must point out to you that the factors that have caused the increase in stabilization stocks as well as increased the assessments to an unbearable level have been caused by factors over which the farmer had absolutely no control.

Mr. Chairman, the policy of the National Grange, as it relates to the excise tax on cigarettes, is as follows: "The National Grange is opposed to making the present excise tax of 16¢ per pack on cigarettes permanent, but, we will support an increase in the excise tax on cigarettes of up to two cents per pack to establish the tobacco equalization fund that will be used to finance the no-net-cost tobacco program." All of us are aware that the cigarette excise tax is supposed to revert to eight cents per pack on October 1, 1985, under the provisions of legislation enacted in 1982. Being realistic, I do not think many of us believe that this tax will ever revert to eight cents. What we are simply asking for is that two of the eight cents that is supposed to revert be designated to establish and maintain the tobacco equalization fund that will finance the no-net-cost tobacco program. I am quite sure, Mr. Chairman, that you will hear from the domestic manufacturing companies for which excise taxes have always had an adverse effect upon consumption. Again, quoting from the March issue of Tobacco Outlook and Situation Report, total U.S. consumption declined from 1982 to 1984 by approximately 5.3%. According to this report, total U.S. consumption includes those removals that are both tax exempt and taxable. I contend that a more realistic figure can be derived from looking at the decline of taxable cigarettes. Using Table 1 of this report, from 1982 to 1984, taxable cigarettes only declined by 2.7%. In my opinion, this is a truer indication of what has actually happened since the excise tax was increased from eight cents to 16¢ on January 1, 1983.

Our friends, the domestic manufacturers of cigarettes, lead us to believe that the decline in consumption, whether it be the 5.3% or the 2.7%, is caused by the excise tax. Again, I quote from the March issue of Tobacco Outlook and Situation Report, Table 4 to dispell this theory. Using filter tips as an example, the net price per thousand of cigarettes has increased from February 1982 through June 1985 by 46.9% or 47%. Using filter tips again, the net price per thousand, excluding the federal excise tax from the same time period, has increased by 40.4% or 40%. The difference between net price and price excluding excise tax has been 7%. It is quite evident that of the 47% increase in the wholesale price of cigarettes between February 1982 and June 1985, only 7% can be attributed to the excise tax and 40% of the increase has been increased income to the manufacturer. To put it simply, giving the excise tax an increase by a factor of 1, the manufacturer's income would be increased by 5.7%. During this same period, inflation has remained rather constant at approximately 5% per year. Cigarette prices have increased at the rate of 11.4%, excluding excise taxes, during this same period, which is almost double the rate of inflation.

Mr. Chairman and members of the Committee, the increase in the price of cigarettes due to increasing the enormous profits of the manufacturers has had far more effect in the decline of consumption than the mere increase in the excise tax. To be exact, this tax has been multiplied by 5.7%. It is interesting that the net return on investment in the tobacco industry is the second highest industry in the United States. According to a report from Fortune Magazine last March, it showed the tobacco industry with a return of 20.3% on their investment was second only to the beverage industry in America.

When the law was passed in August of 1982 to increase the excise tax by eight cents to 16¢ effective January 1, our manufacturers began to increase their prices immediately, resulting in a period of four months at a $4.00 increase per thousand. Their reason for this was to "soften the blow" of the increase in the excise tax effective January 1, 1983.

At this time, we are less than three months away from a supposedly decrease in the excise tax of eight cents. I have seen no indication on the part of our manufacturers that they have begun to reduce the price per thousand at the wholesale level on cigarettes in order to "soften the blow" of the reduction in the excise tax that is supposed to occur on October 1, 1985. On the contrary, a price increase on the excise tax was put into effect on the very day of the hearing before the Ways and Means Committee in Washington.

Again, Mr. Chairman, we strongly support the establishment of a tobacco equalization fund to be financed by the excise tax, and, feel that the impact of the excise tax will have very little effect on consumption of cigarettes in the

United States. It will, as I have stated before, relieve our flue-cured and burley producers of a tremendous financial burden.

Mr. Chairman, I would like to add that the excise tax alone to fund the tobacco program will not solve all of the problems that we face today with our tobacco program. The implementation of the tobacco equalization fund will enable us time to make further adjustments to the program. As an example, we need to decrease our price support to a level more in keeping with the market demands. Our position is approximately $1.50 per pound. We also must develop a new price support formula that will prevent a rapid escalation in the price support, which is one of the factors that has caused our price support to reach an unbearable level. Our recommendation on a new price support formula would be equal weight given to market demands and equal weight given to cost of production to the tobacco farmer. We have submitted our recommendations regarding changes in the present tobacco program to both the Senate and House Agriculture Committees.

In conclusion, Mr. Chairman, the National Grange strongly supports legislation to establish the tobacco equalization fund, which is financed by dedicating up to two cents of the eight cents excise tax now being considered for extension. In my opinion, this approach, along with the other changes we have recommended, will not only save our tobacco program from total destruction, but, also and more importantly, will save the thousands of flue-cured and burley tobacco farmers from economic chaos. It will allow them to continue to be taxpaying citizens of this nation instead of welfare recipients. The total economic base of the southeastern United States is at stake. We urge you to look favorably on this recommendation.

We thank you for this opportunity to express the views of the National Grange.

OICs of America, Inc., 100 West Coulter Street, Philadelphia, Pa. 19144-3496 • (215) 951-2200

REV. LEON H. SULLIVAN
Founder & Chairman of the Board

ELTON JOLLY
President

TO: The Senate Finance Committee Subcommittee on Taxation and Debt Management

The OICs of America goes on record as supporting the sunset of the federal cigarette tax September 30.

O.I.C.A. believes that cigarette excise taxes are regressive. Such taxes place an unfair burden on lower and middle consumers and the elderly poor. Hispanics, Blacks and other minorities share a disproportionate financial burden of such a tax, because they are over-represented in lower income groups. We, therefore, strongly urge the Senate Finance Committee Subcommittee on Taxation and Debt Management to consider other fairer and more equitable means of raising revenue instead of the cigarette excise tax.

Elton Jolly
President
OIC of America

Opportunities Industrialization Centers

Petrin Vending Co.

COMPLETE VENDING SERVICES

16-18 Lindsley Ave. West Orange, N. J. 07052
Phone (201) 325-0227

September 9, 1985

TO: THE SENATE FINANCE COMMITTEE

As president of Petrin Vending Company, in West Orange, New Jersey and nine (9) employees, I would like to go on record, as urging Congress to keep it's promise and allow the Federal Cigarette Excise Tax to sunset back to eight cents (8¢) per pack, on September 30, 1985. We believe the cigarette excise taxes are already too high.

In my opinion, any increase in taxes will certainly cause loss of employment in tobacco farming, and distribution of tobacco products.

Sincerely yours,
PETRIN VENDING CO., INC.

ROBERT E. PETRIN
President

REP/lc

cc Senator Bill Bradley

MALCOLM L. FLEISCHER
Managing Director and General Counsel

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William E. Martin, Chairman of Policy Committee

Retail Tobacco Dealers of America, Inc.

55 Maple Avenue — The Atrium — Rockville Centre, N.Y. 11570 • Telephone (516) 766-4100

STATEMENT OF
MALCOLM L. FLEISCHER
MANAGING DIRECTOR AND GENERAL COUNSEL
RETAIL TOBACCO DEALERS OF AMERICA, INC.
BEFORE THE SUB-COMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE FINANCE COMMITTEE
U.S. SENATE
ON
THE CIGARETTE EXCISE TAX
SEPTEMBER 10, 1985

Mr. Chairman - in keeping with the request of your staff, I am submitting a brief statement.

My name is Malcolm L. Fleischer. I am managing director and general counsel of Retail Tobacco Dealers of America, Inc. (RTDA), a national trade association, formed some 52 years ago during the height of our country's severest economic depression. We represent small business enterprises devoted to the retailing of tobacco and allied products. Some of our members are traditional tobacco shops and others are relatively small family shops and cigar stands.

Unfortunately, the small retailers have few champions in Congress, even though we are important to the economy, and have contributed to the growth and prosperity of the United States. Time and again our particular trade has been set back on its heels because the products we sell are subject to disproportionate and onerous taxation.

Cigarettes, the most important product we sell, has become the whipping boy of state legislative bodies throughout the country, and three years ago the U.S. Congress joined in by doubling the federal cigarette excise tax from 8¢ to 16¢ per package, effective January 1, 1983 but somewhere in your midst there was heart and concern for us and the public, for you placed a sunset clause in the legislation which returns the federal cigarette excise tax to 8¢ per package on October 1, 1985.

We are dismayed that you are considering to extend the date of the sunset clause when some 300,000 small business people throughout the country who sell cigarettes, and the public, are waiting for the relief they are counting on to come their way on October 1, 1985.

Isn't your word your bond? And what consideration do you give to the recent remarks of President Ronald Reagan who in his "State of Small Business Report" transmitted to the U.S. Congress in May of this year had this to say:

"Actions that promote a vigorous small business sector have been and will continue to be at the heart of this Administration's economic plans. Low inflation, reduced and more equitable taxes, fewer regulatory burdens, and a sound monetary policy are the underpinnings of our current growth and will continue to be my primary tools for promoting small business success." (Emphasis supplied).

As far as we know, this position of the President is a bipartisan one, shared we hope by the members of this Committee.

The temporary doubling of the federal cigarette excise tax should not be extended. The tax was increased as a temporary measure to help pass the Tax Equity and Fiscal Responsibility Act of 1982. There would be neither equity nor responsibility in having the present Congress renege on what the previous Congress pledged to the American people.

Cigarette excise taxes are especially unfair to us in the retailing segment of the industry. We retailers get the smallest share of the tobacco sales dollar; whereas, tax collectors on the federal, state and local levels, by contrast take the lion's share. Nearly one half of every dollar spent on smoking goes to government as excise, sales or income taxes.

Excise taxes are unfair to our customers. Smokers have been paying more than other taxpayers for generations. But they receive no more government services than other taxpayers. Moreover, they have been required to pay more regardless of their individual economic circumstances.

For example, Mr. Chairman - a cigarette smoker in Chicago is subjected to a painful tax bite -- 16 cents to the feds, 12 cents to state, 8 cents to the county, and 15 cents to the city. A total of 51 cents a pack inflicted on all smokers alike, rich or poor. That comes to nearly $275 a year for the average smoker.

In our opinion, the increased federal cigarette excise tax was responsible for the outrageous cigarette tax structure in Chicago, and emboldened a large number of states to likewise enact higher cigarette taxes.

The inequity is not limited to Chicago. A study in New York State demonstrated that a family with an income of $15,000 or less a year paid proportionately triple the cigarette tax of a family earning more than $50,000 a year.

It has been estimated that cigarette sales declined by more than 850 million packs a year as a direct result of the doubled federal tax rate. A Federal Trade Commission study issued recently announced that cigarette sales fell 8% in 1983. This translates to an annual income loss of around $107 million dollars to the retail segment. This loss will not be relieved until the 16 cent federal tax rate is allowed to sunset as called for in the present law.

Mr. Chairman, at least 55 million Americans have a sense of resentment about the ever-increasing cigarette taxes.

Thank you for the opportunity to be heard.

SUPPLEMENTARY STATEMENT FOR THE RECORD OF THE HEARING BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT HELD ON SEPTEMBER 10, 1985

Submitted by The Tobacco Institute

At the hearing conducted by the Subcommittee on Taxation and Debt Management of the Senate Finance Committee on September 10, 1985, several witnesses offered figures purporting to measure the adverse health consequences of smoking in terms of mortality, morbidity, and cost to society. As summarized by Senator Bradley, the testimony of these witnesses alleged that the nation is being billed approximately $40 billion for smoking-related illness, - "$14 billion in direct health care costs and $25 billion due to lost earnings, due to morbidity or cigarette-related diseases."

Since the hearing the staff of the Office of Technology Assessment has released a Memo entitled Smoking Related Deaths and Financial Costs. This Staff Memo concludes that the health care costs of smoking-related illness in 1985 will be somewhere between $12 and $35 billion and that productivity losses from this cause will be between $27 and $61 billion.

By this statement for the hearing record, we wish to caution members of the Senate against uncritical acceptance of these data, which have been repeatedly and thoroughly discredited by several independent experts in the fields of economics, statistics, and medicine. We wish also to present in summary form some major arguments exposing the fallacies of the analysis on which such data are based.

The validity of the figures presented to the Subcommittee measuring mortality, morbidity, and cost resulting from illness allegedly caused by smoking depends on a study of deaths among a sample of the U.S. population 20 to 25 years ago. The sample drawn for this study, which was conducted by the American Cancer Society, was far from representative of the total population in terms of such important factors as race, income, occupation and current state of health. The figures based on this sample attribute to smoking all deaths from certain illnesses that occurred among people not classified as non-smokers without considering the amount or the duration of smoking. It ignored confounding factors that are generally recognized as causing or contributing to illness and death such as excessive drinking, improper diet, lack of exercise, environmental pollutants, and occupational hazards. Death from smoking was the verdict even though the smoker may in fact have died from heavy drinking, occupational health hazards, or several other factors, singly or in combination. To determine the type of illness, the underlying cause of death as reported on a death certificate was accepted as conclusive despite notorious and widespread inaccuracy in this source of information.

The American Cancer Society study was comprised principally of healthy, employed individuals. The death rate of non-smokers in the study was substantially less than the non-smoker death rate in the U.S. population, but to compute alleged medical costs for smokers, this lower death rate for non-smokers is applied to the entire U.S. population, with all other deaths assumed to be from smoking. This results in a substantial understatement of deaths among non-smokers, and a substantial overstatement of deaths among smokers. Many non-smoker deaths are therefore classified as smoker deaths, leading to the ironic result that some medical costs, claimed to be due to smoking, are in fact due to the illness and deaths of non-smokers.

Commenting on the recent OTA Staff Memo on Smoking Related Deaths and Financial Costs, Dr. Theodor D. Sterling, Professor of Computing Science at Simon Fraser University, writes, "...the ultimate absurdity of the OTA Report is that it counts approximately 40 per cent of the deaths among white male never-smokers and apparently a third of the deaths among white women never-smokers as deaths due to smoking."

To assume that so flawed a survey could be a reliable basis for the estimates drawn from it at the time it was made, strains credulity. To assume that it is an accurate measure today is a blind leap into the unknown.

To arrive at the figures presented to the Subcommittee, anti-smoking forces make another leap in the dark by an unwarranted assumption that the incidence of claimed smoking-related illness must be the same as the questionable mortality rate derived from the American Cancer Society study. Even they admit that this is an unprovable assumption. Yet it is on this estimate that the figure purporting to reflect the health care costs of smoking is based.

As for the economic costs due to lost productivity which smoking is alleged to impose on society, a distinguished economist, Robert D. Tollison, Director of the Center for the Study of Public Choice of George Mason University, has written,

> There is not one self-respecting economist in the world who takes the public health model of lost production seriously. It is wrong...People may like or dislike the tobacco industry for various reasons, but they ought to...stop all this nonsense about social costs and tobacco.

If for the sake of argument, it is conceded that $25 billion of income is "lost" because of smoking, who is the loser? Not society, but the smoker. If the smoker earns less than he could if he were a non-smoker, he suffers the penalty of a reduced income. If he bears this loss, what logic leads to the conclusion that he should pay a higher tax, which has the effect of adding to his losses? Millions of Americans choose to work part-time rather than full-time and millions more retire at an early age. Should they be taxed more heavily because they "lose" income they would receive if they worked harder and longer?

Admittedly, smokers get sick as do non-smokers. Does the loss they suffer because of illness substantially exceed similar losses by others? Evidence that could be cited on either side of this question is fragmentary and inconclusive. Comprehensive studies proving that smokers are less productive than non-smokers do not exist.

One study published in 1967 in a report of the Department of Health, Education and Welfare entitled Cigarette Smoking and Health Characteristics found that female smokers report fewer diseases than female non-smokers and that moderate smokers, comprising over 72 per cent of the male smoking population and 88 per cent for females, report the fewest number of diseases for both men and women.

Admittedly, when smokers get sick, health care costs are incurred. Are these costs disproportionately high in comparison to the health care costs of others? No comprehensive study can be found to show that they are.

Who pays these costs? Again, no certain answer can be given. Certainly they are paid in large part by smokers themselves through direct payment to providers of health services, insurance premiums, and taxes. It is probable that a part of the health care costs of some smokers, particularly those in the lowest income brackets, is borne by more affluent smokers and non-smokers. The same can be said about the health care costs of low-income non-smokers. Even the recently issued OTA Staff Memo on Smoking-Related Deaths and Financial Costs concludes that "...it is not entirely clear that non-smokers subsidize smokers' ill health." There is indeed no factual basis for the assertion that the health care costs of smokers are subsidized by non-smokers and certainly no justification for imposing higher taxes on smokers to make them pay more of the costs of government-financed health programs.

It is often alleged that smoking-related illness imposes a heavy charge on the Medicare program. Apparently on the basis of this belief, many members of Congress have sponsored legislation to earmark part of an increased cigarette tax for the Hospital Insurance Trust Fund. In fact, nobody knows how many Medicare beneficiaries are smokers although we do know that the percentage of smokers above the age of 65 is considerably lower than any other age group. No study of Medicare tells us what the health care costs of smokers under this program amount to. But, since the Hospital Insurance Trust Fund is financed by a designated part of the payroll tax, we can make a rough estimate of the current contribution of smokers to this Fund. Approximately one-third of its revenue can be attributed to smokers -- an amount that far exceeds even the wildest guesses about the cost of smoking-related illness to this program.

In short, widely publicized figures on smoking-related deaths, illness, and cost are little more than guesswork based on flawed and outdated reports. We trust the Senate will seek more reliable information before legislating on taxes or other matters affecting the tobacco industry.

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August 1985

TO : Members of the House Ways and Means Committee

The Uptown Chamber of Commerce goes on record as supporting the sunset of the Federal cigarette tax on September 30, 1985.

We believe that excise taxes are regressive and place an unfair burden on lower and middle income smokers in general, and on blacks and other minorities in particular.

We further believe that Congress should keep its promise to the American people and allow this tax to sunset. If cigarette taxes should be raised at all, we believe it should be left to the states in need of this revenue in keeping with this administration's plan to reduce taxes and return more revenue raising responsibilities to the states. Only in this way will states truly become more fiscally responsible and independent, consistent with the philosophy and approach of the administration of Ronald Reagan.

Hopefully, you will give our thoughts all due consideration.

LW/cn

. . . The Business of Business, Is People . . .

The Washington Business Group on Health is a membership organization comprised of major employers who recognized, eleven long years ago, the necessity of responsible participation in health policy and cost management deliberations. Although small in number, the impact of the purchasing decisions of these companies is of undeniable magnitude: approximately 50,000,000 insured employees, retirees and dependents.

The WBGH membership has a keen interest in eliminating the unnecessary economic and societal costs associated with smoking. For employers those costs are underscored by the following information:

- At least 30 percent of all cancers, 25 percent of all cardiovascular disease, and 80 percent of all deaths from respiratory disease are related to smoking.
- About 15 percent to 19 percent of American businesses have reported that their nonsmoking employees have claimed illnesses caused by on-the-job exposure to second-hand smoke.
- Second-hand or passive smoking can cause not only eye irritation but also cardiovascular and respiratory disease, and it now appears even lung cancer in employees who do not smoke.
- According to one important study, each smoking employee can cost an employer additional $336 to $601 a year in increased insurance costs, absenteeism and sickness costs, lost productivity, second-hand smoking costs, and occupational health costs.

Washington Business Group on Health

CIGARETTE EXCISE TAX

Written Statement

Submitted to:

Senate Finance Committee
Subcommittee on Taxation and Debt Management

by

The Washington Business Group for Health

August 20, 1985

229½ Pennsylvania Avenue, S.E. Washington, D.C. 20003 (202) 547-6644

Though there is little reduction in cigarette consumption due to increased taxation, it does serve to provide an economic disincentive for marginal smokers. Taxing cigarettes is regressive, but it would be worthwhile were the revenues used to offset additional health care costs absorbed by the government through Medicare, Medicaid and other federal health programs.

A certain irony should be noted with respect to the increase in the cigarette excise tax. By its very nature it is regressive. The Administration's proposed taxation of health insurance in Treasury II is also regressive and, for that reason, has elicited a great hue and cry. One would think these two forms of revenue enhancement, each being regressive, would find similar opponents, yet the tax floor has evoked a much greater response.

Since taxation is a realistic alternative, the WBGH endorses the AARP move integrated into Sen. Heinz's MIRA. Raise the tax to 32 cents and dedicate the revenues to the Medicare Trust Fund. That fund yields inordinate sums of money annually for the health care treatment of cigarette smokers.

The WBGH endorses any initiative seized by the Congress to reduce or minimize the consumption and attending costs that are linked to cigarettes.

WCBPA WEST COAST BLACK PUBLISHERS ASSOCIATION

STATEMENT FROM
DR. WILLIAM H. LEE
PRESIDENT,
WEST COAST BLACK PUBLISHERS ASSOCIATION

We are concerned about the dangers of a proposed increase in the excise tax on cigarettes.

Such an increase would weaken the national tobacco industryand, in trunm have a harmful effect on other industries and groups. It would reduce national sales, cause the loss of thousands of jobs and do great damage to the American print media.

Studies have shown, in addition, that excise taxes impact most heavily on those least able to pay and even heavier on black American consumers.

We recommend that Congress allows the 8 cents a package excise tax -- added in 1982 to the existing 8 cents a package tax on cigarettes -- to end on October 1, 1985, as promised. This would stabilize the cigarette tax at 8 cents a package.

P.O. BOX 5034

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